IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF PUERTO RICO

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In re

THE FINANCIAL OVERSIGHT AND MANAGEMENT BOARD FOR PUERTO RICO,

as representative of

THE COMMONWEALTH OF PUERTO RICO, et al.,

Debtors.

PROMESA
Title III
Case No. 17-BK-3283 (LTS)
(Jointly Administered)

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THE OFFICIAL COMMITTEE OF UNSECURED CREDITORS OF THE COMMONWEALTH OF PUERTO RICO,

as agent of

THE FINANCIAL OVERSIGHT AND MANAGEMENT BOARD FOR PUERTO RICO

as representative of

THE COMMONWEALTH OF PUERTO RICO,

Plaintiff,

v.

BETTINA WHYTE,

as agent of

THE FINANCIAL OVERSIGHT AND MANAGEMENT BOARD FOR PUERTO RICO

as representative of

THE PUERTO RICO SALES TAX FINANCING CORPORATION.

Defendant.

Adv. Proc. No. 17-00257-LTS

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New York, NY.
April 10, 2018
9:40 a.m.

Cross Motions for Summary Judgment

Before:

HON. LAURA TAYLOR SWAIN,

District Judge

APPEARANCES

JENNER & BLOCK LLP
Attorneys for the Retiree Committee
BY: RICHARD LEVIN
ROBERT GORDON

PAUL HASTINGS LLP
Attorneys for Commonwealth Agent
BY: LUC A. DESPINS
JAMES BLISS

WILLKIE FARR & GALLAGHER LLP
Attorneys for COFINA Agent
BY: MATTHEW A. FELDMAN
ANTONIO YANEZ, JR.
ALEXANDER CHENEY
-and-
KLEE TUCHIN BOGDANOFF & STERN LLP
BY: KENNETH N. KLEE

KRAMER LEVIN NAFTALIS & FRANKEL LLP
Attorneys for the Mutual Fund Group
BY: THOMAS MOERS MAYER
PHILIP BENTLEY

MILBANK TWEED HADLEY & McCLOY LLP
Attorneys for Ambac
BY: ATARA MILLER
DENNIS DUNNE

QUINN EMANUEL URQUHART & SULLIVAN, LLP
Attorneys for the COFINA Senior Bondholders' Coalition
BY: SUSHEEL KIRPALANI
DAVID COOPER
ERIC KAY

WHITE & CASE LLP
Attorneys for Puerto Rico Funds
BY: JASON N. ZAKIA

ROBBINS RUSSELL ENGLERT ORSECK UNTEREINER & SAUBER LLP
Attorneys for the GO Group
BY: MARK T. STANCIL
DONALD BURKE
JOSHUA S. BOLIAN
-and-
PAUL WEISS RIFKIND WHARTON & GARRISON LLP
BY: ANDREW N. ROSENBERG
KAREN R. ZEITUNI

PROSKAUER ROSE LLP
Attorneys for the FOMB
BY: EHUD BARAK
STEPHEN L. RATNER

WEIL GOTSHAL & MANGES LLP
Attorneys for National
BY: JARED FRIEDMANN
MARCIA GOLDSTEIN
GABRIEL MORGAN
JEREMY CAIN

(Case called)

THE COURT: Again, good morning, everyone. I welcome counsel, parties in interest, members of the public, members of the press, those in San Juan and in the overflow courtroom and observers by telephone.

As always, we have in mind the people of Puerto Rico and all of those who are interested in Puerto Rico's future, including GO and COFINA bondholders on the island and on the mainland.

I remind you that consistent with court and judicial conference policies and the orders that have been issued, there is to be no use of any electronic devices in the courtroom to communicate with any person, source, or outside repository of information, nor to record any part of the proceedings. Thus, all electronic devices must be turned off unless you are using a particular device to take notes or to refer to notes or documents that are already loaded on the device. All audible signals, including vibration features, must be turned off.

As provided in this Court's standing order, no recording or retransmission of the hearing is permitted by any person, including, but not limited to, the parties or the press. Anyone who is observed or otherwise found to have been texting, e-mailing, or otherwise communicating with a device in the courtroom during the court proceeding will be subject to sanctions, including, but not limited to, confiscation of the

device and denial of future requests to bring devices into the courtroom.

Please also be mindful of your other possessions and take all of them with you, including any trash, when you leave the courtroom at the conclusion of these proceedings.

We are here today for oral argument of the cross motions for summary judgment in the Commonwealth/COFINA dispute, which is adversary proceeding 17-257 in the Commonwealth Title III case.

Specifically, the Court will hear argument today on the cross motions filed by the Commonwealth agent, the Official Committee of Retirees, the Ad Hoc Group of General Obligation Bondholders, the COFINA agent, the COFINA Senior Bondholders Coalition, and the Mutual Fund Group and Puerto Rico Funds. I have reviewed the briefing carefully, so you need not worry about that.

And we have divided the time in groups as between COFINA interests and Commonwealth interests and the parties have further subdivided the time allocations that they were given, and we will run timing on our clock with the lights accordingly.

Speak from the podium, speak into the microphone so that everyone can hear you in all of the courtrooms and on the telephone, and I appreciate your cooperation with all of these logistical considerations.

I understand that the COFINA-related interests are going to go first, beginning with 30 minutes for opening by Mr. Yanez. Is that correct?

MR. YANEZ: That's correct.

THE COURT: Please come to the podium, sir.

MR. YANEZ: Good morning, your Honor, may it please the Court. Antonio Yanez of Willkie Farr & Gallagher on behalf of the COFINA agent.

Your Honor, summary judgment should be entered for the COFINA agent because it is Puerto Rico law that COFINA owns the pledged sales tax. Let me begin with some context. COFINA was created in 2007 to help the Commonwealth emerge from a financial crisis. The idea was that COFINA would be separate from the Commonwealth, that the pledged sales tax would be transferred to COFINA, and that COFINA would issue bonds secured by the pledged sales tax which it could do on good terms precisely because it would own the pledged sales tax and the pledged sales tax would be there to repay the bonds.

THE COURT: Why is it called the pledged sales tax if the intent was to transfer title to the sales tax from the very beginning? Why isn't it just COFINA sales tax or the sales tax?

MR. YANEZ: It is referred to as the pledged sales tax in English, your Honor, because it provides security to a COFINA bondholder vis-a-vis COFINA.

THE COURT: So the reference to pledge is to the relationship between COFINA and its bondholders as opposed to the relationship between COFINA and the Commonwealth.

MR. YANEZ: That's correct, your Honor. And, as I say, the idea was that the pledged sales tax would be separate precisely to establish a stream of revenue that was separate from the Commonwealth to repay the COFINA bonds. That was the idea. It is what is reflected in Puerto Rico law in the COFINA enabling legislation. It's what investors were told repeatedly as these bonds were marketed, and COFINA achieved its purpose. There were $16 billion worth of COFINA bonds sold. That $16 billion went to the Commonwealth and the Commonwealth used the $16 billion to pay down debt and to pay for other expenses.

Now, the Commonwealth parties say that in addition to having gotten the $16 billion, the Commonwealth gets the pledged sales tax, too. They get both. That's their position. They get the proceeds from the COFINA bonds, which they have already received and have already used, and they get the pledged sales tax that is supposed to be there to repay the bonds. There is no legal basis for that result, your Honor, none. The pledged sales tax is COFINA's property for three straightforward reasons. First, the COFINA enablin legislation transferred the pledged sales tax to COFINA and made it COFINA's property.

THE COURT: As of when?

MR. YANEZ: Upon enactment of Act 56.

THE COURT: But as of enactment of Act 56 it had not been collected, to any great extent nobody could take it, spend it, put it anywhere. How do you own something that doesn't exist?

MR. YANEZ: Because the tax existed, your Honor. This notion that future property can't be transferred, which I know the Commonwealth parties assert, it's a false premise. The tax existed. It gave rise to a stream of revenue and that revenue can be transferred, your Honor, and we cite cases holding that. That's the basis of securitizations around the country. In the commercial context it has been found that future revenues can be transferred in the form of rents, in the form of properties or in the form of royalties, I should say. And in those cases, too, Judge, the rents have not been collected, the royalties hadn't been collected. The sales tax streams that underlying these other securitizations had not been collected. Yet, courts hold that the stream can be transferred.

THE COURT: In all of those situations you have a tangible thing that can be owned that is potentiall transferable that is throwing off a defined stream of revenues. Here, as I understand it, constitutionally, the stream of revenues arises from a taxing power. The Commonwealth can't alienate its taxing power. The Commonwealth can't even alienate its collection power. The only way this can exist is

for the Commonwealth, to truly exist in the future, the future stream is for the Commonwealth to retain significant rights associated with the taxing power in order for these revenues to be realized.

So isn't this more like the cases? And a couple of them were cited. There is a patent case, I think, *DDB Tech* and there is a *Tin Pan Alley* songwriting case where rights in musical works to be created or rights in a patent to be created were contractually transferred as of the time before they existed, and then the courts essentially hold that at the time the thing comes into existence, by operation of the prior agreement, it becomes the property of the buyer, but not in a metaphysical sense 10 years before it existed.

MR. YANEZ: Couple of reactions, your Honor. First on the notion that in the cases to which I've referred there is an existing tangible asset, there are many cases in which there is not an existing tangible asset. There are cases that we cite in the municipal finance context in which the asset was the same exact asset we are talking about here, which is a tax that has been imposed that gives rise to a stream of revenue. So too in the royalty cases where the asset could be a song, a composition.

THE COURT: That's a fixed expression that has a value that is sold.

MR. YANEZ: So too is the tax, your Honor. And the

courts hold that with respect to royalties there is title to the composition proper on the one hand and there is the revenue stream on the other. Both are property, both can b transferred.

And I would point out, Judge, that on the subject of collection, we have got two cases, one case, *FS Media* and another case, the *State of Ellington*, in which collection remain in the hands of the transferor.

The way it worked in both of those cases was that the future revenue stream associated with musical composition was sold. The seller retained title to the musical composition. The seller received the royalties that were associated with the musical composition and then passed that along and still the courts held that there was a transfer.

THE COURT: I have to confess, I didn't memorize th facts in every single case you cited. Did the courts in those cases speak specifically to the effective timing of the transfer and is that something that's important here? Does it make a difference to you whether COFINA owned it in 2007 or whether COFINA owns it at the moment of collection or at the time of deposit into the DST or some other time?

MR. YANEZ: Your Honor, those cases state expressly that there was a transfer. Do they get down to the details and say the transfer occurred at this moment? It's implicit in what they say. But I can't point the Court to a specific

statement. But it is the upshot of those cases that there was a transfer at that moment and that transfer required the seller in each instance to pass along the revenues as they came in.

In terms of the timing of the transfer here, Judge, I do believe that the way to think about this issue, we would urge, is as an issue of statutory interpretation and that the timing of the transfer is reflected in the COFINA enabling legislation.

The Court is familiar with the language, but I'd like to quote it just for a moment. What Act 56 says is that the dedicated sales tax fund and all funds deposited therein on the effective date of this act and all but future funds that must be deposited are hereby transferred to and shall be the property of COFINA.

THE COURT: And you read shall as a present mandate as opposed to speaking to a future state.

MR. YANEZ: I do, your Honor, and I'll tell you why There are three things in that sentence that I just read. There is the dedicated sales tax fund. There are the funds already on deposit, and there are the future funds that must be deposited. That's the pledged sales tax.

With respect to the first two items, everyone agrees, the Commonwealth parties concede that with respect to the first two items, they were transferred to and became COFINA's property upon enactment of Act 56.

THE COURT: Whatever was actually in them at the time.

MR. YANEZ: Yes, your Honor. But the issue is with respect to the pledged sales tax. They say that those are different. There are three items in the same sentence. All three items are transferred to and shall be the property of COFINA. Everyone agrees that the first two items are transferred upon the effective date.

But the argument is that there is somehow a difference with respect to the third item and that's just not there in Act 56, Judge. Act 56 doesn't say that the pledged sales tax is to be treated differently than the other two items. It doesn't say that there should be some condition that's applied to the transfer. It doesn't say that the transfer of the pledged sales tax only becomes effective upon the deposit of those funds.

What it says with respect to all three, and the pledged sales tax no less than the other two, is that those items are hereby transferred to, meaning that the transfer happens upon enactment. It's in the present tense, Judge, and from the transfer forward they shall be the property of COFINA. That is, we urge, the straightforward plain meaning interpretation of the statutory language.

It is an interpretation, Judge, that respects the legislative assembly's decision to treat the pledged sales tax like the other two items. It respects the language employed by

the legislative assembly, including its use of the present tense, and it respects the legislative assembly's determination not to have imposed a condition, which is really what the Commonwealth parties are arguing for. Their argument is that the transfer of the pledged sales tax was conditional upon deposit of those funds, that it required deposit of those funds in order for the transfer to become effective. That is just not what Act 56 says, Judge.

THE COURT: I would just like you to address two other aspects of the question that I asked.

So the Commonwealth agent argues deposit, and I think we understand why there is more space between collection and deposit potentially than just a collection. If the moment of an automatic transfer of title of this happened at collection, let's leave aside deposit, is that something that is potentially consistent with the statutory language? When it comes into being without anything further having been done, then it comes into being such that it belongs to COFINA. And does that timing make a legal difference for you that's kind of critical to this ownership issue that I should be focused on?

MR. YANEZ: I think that with respect to the first part of the question, whether a transfer of ownership or transfer of title upon collection, whether that's consistent with the statutory language, there is separate statutory language in Act 56 that requires the funds to be directly

deposited when they are collected. It is certainly consistent with that statutory language.

The question is why. And the reason that direct deposit is required is because there is an effective transfer at the moment Act 56 became effective and it is in that respect, Judge, that I think an automatic transfer as collection happens is not consistent with the statutory language because it doesn't reflect the direction in the statute that the pledged sales taxes are hereby transferred. Not that they are going to be transferred when they are collected. The stream that's created from the tax is transferred at the moment of enactment.

In terms of whether it makes a difference, I think the Commonwealth parties think that it makes a difference. I think they have asserted that somehow if it is some transfer that happens in the future that that alters the legal landscape. I will leave that to them to argue.

From our perspective, Judge, it doesn't make a difference and the reason it doesn't make a difference is that it is because COFINA owns the property that it is required to be deposited into the dedicated sales tax fund and that it comes to us at the moment of collection. So the answer to your question is they are all bound up together.

THE COURT: So the Commonwealth has no rights in these future revenues as of 2007?

MR. YANEZ: Correct.

THE COURT: Nonetheless, the taxing power and the collection power exist. There is no inconsistency in that?

MR. YANEZ: There is not, your Honor. The antisurrender provision in the Puerto Rico Constitution applies to infringements by the other branches of government on the legislative assembly's ability to tax on. The legislative assembly has the authority as part of its taxing power both to spend and to allocate tax proceeds, and this is an allocation of tax proceeds and it is an expenditure where they paid over the pledged sales tax in exchange for $16 billion.

This dialogue, Judge, highlights the important focu that should be on and that is on the language of the statute. The language of the statute is critical here because, as I've said, this is a case of statutory interpretation first and foremost. And the Commonwealth parties try to minimize the significance of the statutory language. Really, they invite the Court to disregard it. There are two main arguments. One is that future property can't be transferred. I've already addressed that. The other argument is that the Court should look through the form to the economic substance and if the Court does that, it will see that there was no true sale here. The Commonwealth parties argue that ownership wasn' transferred because Puerto Rico retains the right to eliminate the SUT and they point to accounting and other materials

outside the statute as further supporting the notion that there was no transfer here. Those arguments are addressed in our papers. I am not going to recite everything that we say in our papers on that subject, but I do want to make a few key points.

First, the Court cannot look through the words of the COFINA enabling legislation. The law, as I've said, is that statutes must be interpreted and enforced according to their plain meaning. That is what I mean when I say that this is a case first and foremost about statutory interpretation. The law in that regard requiring interpretation and enforcement of the plain meaning of the statute has been articulated by the Supreme Court of the United States. It's been articulated by the First Circuit. It has been articulated by the District of Puerto Rico. All of them repeatedly, your Honor. In fact, the First Circuit has explained that statutory construction in Puerto Rico begins with the text of the underlying statute and ends there as well.

THE COURT: But the defeasance or the elimination or reduction language and the substitution language are in the statute. I didn't have to look through or behind the statute to find that the Commonwealth retained the right to eliminate or reduce this thing that you say COFINA owned in 2007 and also retains the right to say, you don't get that thing that you own. We are going to give you something else. In focusing on the statute I don't see how I can avoid those issues.

MR. YANEZ: Two responses, your Honor. With respec to the substitution point, substitution is required to the extent that the Commonwealth wanted either to reduce or to eliminate the pledged sales tax. Others will speak to that subject in more depth.

But even assuming that the Commonwealth has retaine the ability to eliminate the pledged sales tax, that is power, Judge, that governments retain at all times with respect to all property. It doesn't mean that citizens or, in this case, COFINA doesn't own the property until the government takes that action.

THE COURT: And when the government takes that action, what is that? Is that conversion? Is it a breach of contract? The Commonwealth says it can't be a constitutional taking because of the relationship between the instrumentality and the territorial government. What is that?

MR. YANEZ: I think it is potentially all of those things, Judge. I think that it can be a taking. I think that it can be a breach of contract. I think it can be conversion. And I think it can be an action in violation of the statute which should itself give rise to a cause of action on behalf of COFINA or COFINA's bondholders.

With respect to true sale, Judge, I won't belabor the point. True sale, as we have said in our papers, is a contract law concept. It is not a concept that applies to statutory

interpretation. None of the cases that are relied upon under the true sales cases that are relied upon by the Commonwealth parties apply in the context of statutory interpretation. And with respect to the threshold question, whether the Court can look through the statutory language to the effect that the pledged sales tax is transferred and is the property shall be the property of COFINA, the Court can't ignore that language on a true sale basis.

The same is true with respect to the accounting and the other materials outside of the statute. To use the accounting materials, to just pause on those for a moment, whether those help the Commonwealth parties, I don't know. They seem to think that they do. But the accounting materials, like lots of other materials, including the log itself, state explicitly that the COFINA-enabling legislation transferred ownership of the pledged sales tax. But regardless of how they might be read, the key point is that those and the other materials outside the statute should not be considered by the Court in connection with statutory interpretation. The Court's decision should be based on the statutory text.

THE COURT: Because your position is that the statute is unambiguous, notwithstanding the simultaneous use of is hereby transferred, shall be in the future and the other things that have been argued as potential heads of ambiguity.

MR. YANEZ: That's correct, your Honor. I would ad

one point to that. What the First Circuit requires and what they have said is an undeniable textual ambiguity is required to move outside the statute. Our position it is unambiguous. Certainly, there is no undeniable textual ambiguity

Let me turn to the next point, which is that the legislative assembly had the authority to transfer the pledged sales tax. From our perspective, Judge, it's taking a step back.

There are three critical points here. One is that the pledged sales tax was transferred through Act 56. Two is that the legislative assembly had the authority to transfer the pledged sales tax. And third is that the more specific and frankly more limited constitutional provisions that have been relied upon by the Commonwealth parties don't detract from the legislative assembly's power to have transferred the pledged sales tax.

Focusing on the power to transfer, that resides in the legislative assembly's taxing and police powers. The Puerto Rico Constitution gives the legislative assembly broad authority when it comes to matters of taxation. The Supreme Court of Puerto Rico has confirmed that taxing authority includes within it the power to spend and the power to allocate tax revenues. The legislative assembly separately has broad police powers to extend to economic matters.

Now, the Retirees seem to dispute the extent of the

police power, but that's not really where the parties have joined issue. Where the parties join issue here on constitutionality is really over the separate constitutional provisions, the debt limits, the balanced budget clause, and the debt priority clause. They argue that those, either together or separately, limit the legislative assembly's power to transfer the pledged sales tax. None of them do. I will speak to each individually, Judge, but I want to make a couple of points at the outset.

One is that the general obligation bondholders refer to the constitutional provisions at issue here as a series of interlocking protections that work together to have prevented the transfer of the pledged sales tax. The constitutional provisions can't prohibit the transfer. They can't have prohibited that transfer collectively if none of them does individually. And none of them does, as I will come to.

The other point is that the Commonwealth parties argue that their constitutional interpretation can involve considerations outside the text of the relevant constitutional provisions. Whatever that might mean, there has to be some basis in the text of the Constitution to find a constitutional violation and there is not, your Honor.

I will begin with the debt limits. As the Court knows, these are limits on the amount and maturity of debt, and they apply, by their terms, only to full faith and credit debt.

There is no dispute about that. Debt limits apply to direct obligations of the Commonwealth for money borrowed directly by the Commonwealth and backed by its full faith and credit.

Separately everyone agrees that COFINA debt is nonrecourse debt and that the legislative assembly had the authority to issue nonrecourse debt. That should end the analysis, your Honor. That should be the end of the analysis on the constitutional debt limits. There is no violation because the legislative assembly's authorization of COFINA debt -- to say it differently, the legislative assembly's authorization of COFINA debt can't have violated the debt limit and does not violate the debt limits because the debt limits don't apply to COFINA debt.

THE COURT: The constitutional convention intended for there to be the potential for the legislative assembly to essentially put the Commonwealth in irretrievable lock up to its eyeballs. As long as they said it's not a pledge of full faith and credit, they can effectively alienate every valuable asset and potential piece of revenue of the Commonwealth. As long as they don't say full faith and credit, that's not a violation of this debt limit?

MR. YANEZ: That's correct. It is not a violation of the debt limit. There is no constitutional prohibition on the issuance of nonrecourse debt. That's not to say that there aren't limits. There are limits from a practical perspective

that are imposed by the market and there are limits that are imposed by the democratic process. As legislators seek reelection, they will articulate or they can articulate their views on these subjects. They will be called upon to answer for past action and past views that they have held and the people of Puerto Rico can decide.

At the end of the day, Judge, the Puerto Rico Constitution places a limit, and it's a very specific limit, on one kind of debt, full faith and credit debt, and it doesn't speak to and, therefore, does not limit other kinds of debt. Instead, it relies upon the discretion of the legislative assembly.

Now, it is true that the way in which that discretion has been exercised is now being criticized and it may be true that those criticisms are well taken, but that does not mean that the Constitution didn't grant that discretion to the legislative assembly to begin with or the fact that someone can now legitimately or otherwise second-guess the legislative assembly, meaning that there has to be a constitutional violation.

The other point I would add, your Honor, is with respect to the reach of the constitutional debt limits. The text matters. The text, as I've said, applies to direct obligations of debt issued directly by the Commonwealth for which its full faith and credit is pledged. To hold that it

extends to debt that is not directly issued by the Commonwealth and is not direct debt of the Commonwealth for which the full faith and credit is not pledged is simply to ignore. That's not to interpret the constitutional debt limits. It is to ignore them.

Turning to the balance budget clause, there is no violation there either. All the balance budget clause says is that appropriations for any fiscal year shall not exceed total resources estimated for that year.

THE COURT: That's what it says in Spanish.

MR. YANEZ: It is.

THE COURT: And they argue that the English version that says total revenues is the definitive version.

I know that you are on yellow light. I am going to put another three or four minutes on your clock because unless your colleague is planning to argue the English Spanish issue, I'd like to hear you walk through your interpretation of the process that led to Spanish being definitive.

MR. YANEZ: The process is this, Judge. The Puerto Rico Constitution was debated, passed, and adopted in Spanish. It is true that as part of that process it had to be approved by the United States Congress. Law 600, which is what they rely on, and law 447 speaks to that, but those provisions taken together result in the Congress receiving a translation, the Congress approving that translation, and then authorizing the

Constitution to be adopted in Puerto Rico, which happened through a combination of legislative and public functions in Puerto Rico, necessarily happened in Spanish.

THE COURT: And so you are saying that once things happened in Washington it had to go back? I think the statute says to the constitutional convention and then a proclamation by the governor in order to be effective, and both of those things would have happened in Spanish and, therefore, Spanish is the definitive version?

MR. YANEZ: Yes, your Honor. The governor and the people of Puerto Rico.

THE COURT: Starts and ends in Spanish in Puerto Rico?

MR. YANEZ: Yes.

Let me turn to available resources. The pledged sales tax is not available resources because it was transferred to and is COFINA's property. It is no more available to the Commonwealth and any other asset that's been transferred. That is the plain meaning of available, your Honor. Here, too, the Commonwealth parties read into the debt priority clause restraints that are not just there. They read substantive constraints on the legislative assembly's taxing and police powers into the debt priority clause by asserting that available means that certain assets cannot be transferred, certain court tax revenues can never be transferred and, that assets can't be rendered unavailable simply by transferring

them.

The text of the debt priority clause doesn't say anything like that, Judge. It doesn't say that certain resources have to be available. It doesn't say that the legislative assembly can't transfer tax proceeds. It doesn't say that tax proceeds that have been transferred are somehow still available to the Commonwealth.

Judge, it doesn't make sense that these kinds of substantive limitations were what was intended. The whole argument boils down to the word available. It is, again, that the debt priority clause places significant constraints on the legislative assembly's taxing and police powers, that this was part of a carefully conceived and implemented constitutional framework and that the vehicle for expressing these significant constraints on important powers that are expressly granted elsewhere in the Constitution is the word available and the phrase available resources. That just makes the word available do too much work, your Honor.

The more logical conclusion is that the framers would have been more explicit if a limitation along those lines was intended. If this was the culmination of a series of interlocking protections, the more logical conclusion is that the framers would have stated clearly that the debt priority clause took back power from the legislative assembly that was granted earlier and elsewhere in the document. It would have

been explicit about what the limitations are. And if some of the resources had to be available at all times, they would have said that.

The other point that I will make here is that the Commonwealth parties' reading places the legislative assembly in an impossible position. The debt priority clause operates in years where there is a budget shortfall. That's what it says by its terms. There was no shortfall in 2007 when the pledged sales tax was transferred, so the debt priority clause didn't restrain the transfer then. Nothing in the text of the debt priority clause indicates that transfers that have already happened can be invalidated retroactively, and to hold that it does would place the legislative assembly in the impossible position of never knowing what it can transfer because any transfer might be undone if there is a budget shortfall in later years.

MR. YANEZ: Thank you, your Honor.

THE COURT: Mr. Kirpalani for 20 minutes.

MR. KIRPALANI: Good morning, your Honor, may it please the Court, Susheel Kirpalani of Quinn Emanuel Urquhart & Sullivan on behalf of the COFINA Senior Bondholders' Coalition.

I think your Honor is aware, my client is owed almost $4 billion in senior and subordinate funds.

I am going to do my best not to cover the ground that Mr. Yanez covered, but there were a couple of questions your

Honor asked that if I have time, either now or at rebuttal, I'd like to try to address.

But for now I'd like to focus on two areas, two discrete areas: First, whether there is anything in the bankruptcy code or PROMESA that trumps Puerto Rico law in deciding which debtor owns the property in dispute; and, second, whether the Commonwealth's reservation of constitutional power to modify its tax laws means COFINA is not the owner of the dedicated sales tax.

First and foremost, what is the source of property rights in a bankruptcy case? Due to our system of dual government in the United States, the question is not whether federal law could preempt state law, because we know we can. The question is whether Congress intended to do so here or whether it intended to respect state's rights, specifically the rights of Puerto Rico.

There is a very clear rule that we must follow when interpreting federal bankruptcy law. The U.S. Supreme Court has made it crystal clear that in bankruptcy cases there is a presumption against preemption. You need to have a controlling federal rule of law in order to displace state property law.

(Continued on next page)

MR. KIRPALANI: The relevant case law from the Supreme Court is *Nobelman v. American Savings* case, the *Barnhill v. Johnson* case. These cases stand for the proposition that in the absence of an express controlling federal rule of law, property interests and interests in property are creatures of state law.

The same was held in the *Jefferson County, Alabama*, case and there, it's important, Judge Bennett noted that in particular, a property interest must be "afforded in federal bankruptcy court the same protection the holder would have under state law if no bankruptcy had ensued." That's an important concept, because you're going to find it in PROMESA, and we'll get to that.

Indeed, Congress and the courts have repeatedly emphasized that the Bankruptcy Code is not intended as a general matter to preempt state law, and they look to other places in the U.S. Code. They look to Title 28. Title 28, Section 959(b), even if it doesn't apply to this fact pattern, it doesn't apply to the fact pattern the Supreme Court relied on in *Midlantic National Bank v. New Jersey Department of Environmental Protection* either, which is an abandonment case. There, the Supreme Court said the section "nevertheless supports our conclusion that Congress did not intend for the Bankruptcy Code to preempt all state laws that otherwise constrained the exercise of the trustee's power."

This is even more so, your Honor, and you know this from your other cases, from other proceedings in these Title III cases, that in the chapter 9 context, where sovereign immunity is sacrosanct, Section 903 of the Bankruptcy Code has been held to be the constitutional mooring for municipal debt adjustment, and that makes clear that nothing in chapter 9 should be interpreted to limit a state's power in respect of creating property rights.

The court held, in the *New York City Off-track Betting Corp.* Southern District bankruptcy case, which is cited in our papers: "Nothing in Chapter 9 may be interpreted to interfere with the power of a state to control its municipalities." It necessarily follows that debtors under Chapter 9 must follow state laws, at least those that are not preempted by federal law. That constitutional mooring principle from Section 903 was included by Congress in PROMESA in Section 303.

The Supreme Court has expressly held, your Honor, that the Bankruptcy Code does not preempt state law, especially in areas of creating property rights. The leading case is Justice Scalia's case in *BFP v. Resolution Trust*, from 1994. Justice Scalia told us, "federal statutes impinging upon important state interests cannot be construed without regard to the implications of our dual system of government," and "to displace traditional state regulation in such a manner, the federal statutory purpose must be clear and manifest."

Otherwise, the Bankruptcy Code will be construed to adopt rather than displace preexisting state law.

There was a decision by the Eleventh Circuit that came out after this lawsuit was filed, *In Re Northington*, cited in our papers, a late 2017 case, and there, it was a Georgia statute, which the courts below were interpreting to see how they get interpreted in the bankruptcy case, and this is what the Eleventh Circuit had to say "Given the acknowledged background principle at work here -- namely, that property is created and defined by state law -- we should hold that the Bankruptcy Code prevents and counteracts the ordinary operation of Georgia's pawn statute only if we find some clear textual indication that Congress intended that result."

No greater jurist than Justice Sotomayor, when she sat in this courthouse, for the Southern District of New York, in the *First Fidelity* case, 1995, cited in our papers, said, "The U.S. Supreme Court has ruled that property interests, including those at issue in bankruptcy actions, are created and defined by state law. That was a New Jersey case where there was a prepetition assignment of rent. She said: I can't decide this. There's no federal common law here. There's nothing in the Bankruptcy Code here. I look to what New Jersey would say.

And recently Justice Sotomayor, in the *Merit Management* case, cautioned all the federal courts once again, don't invent things that are not in the Bankruptcy Code. That

was in the *Merit Management* case, your Honor, also cited in our papers.

Your Honor, when you sat as a bankruptcy court judge in the Eastern District in 2000, in the *In Re President Communications Network* case, said the same thing. This is bedrock bankruptcy principles. Bankruptcy estate is determined in accordance with the applicable nonbankruptcy law

So, what about Puerto Rico?

We found a case, your Honor, in Puerto Rico, written by Judge Tortorella, when he sat in the district court, from Puerto Rico, and his ruling was affirmed by the First Circuit in 1980. The case is *Segovia Development Corp. v. Constructora Maza, Inc.*, 628 F.2d 724. The First Circuit explained, and I quote: "The Bankruptcy Act does not undertake to determine what property belongs to the bankrupt as to the date of bankruptcy, or the existence, priority or validity of liens on such property. Questions of that nature are determined by reference to the laws of the state," and he was referring to Puerto Rico when he said that. This is in footnote 4 of the decision at page 726. It's the First Circuit decision.

Judge, this case was not cited in any of the papers. We did inform counsel prior to the hearing that we may reference it today. I apologize for that.

The cases cited by the Commonwealth's side really are to the contrary. They cite not that First Circuit case but

some other First Circuit cases, like *Ground Round*. *Ground Round* didn't reject state law. In *Ground Round*, the First Circuit did their best to try to replicate, What would the state of Pennsylvania say about these particular property rights? That's exactly what your Honor's being asked to do here as well.

They cite other cases, which I will coin the phrase "idiosyncratic cases," where a federal policy or a federal statute was interfered with by some bizarre notions of state law, and in those rare situations, which don't apply here, the court held that federal law is going to preempt the idiosyncratic state law. There's nothing idiosyncratic about creating a securitization. There's nothing idiosyncratic about the statute at all. And most important, there is no competing federal statute, certainly not in the Bankruptcy Code, so let's look at PROMESA, because that would be an important place to start.

In PROMESA, there are four specific statutes that I want your Honor to review with me, if you will, please. What we'd like to mention, to begin with, is we've got, first and foremost, Section 301 of PROMESA. 301 does a couple of things that are directly germane to this issue. First, it does not include Section 541. The property of the estate cases, therefore, that are cited by the Commonwealth party are completely irrelevant to the issues here, even though they

don't go as far as the Commonwealth parties say they do.

Section 201(b)(1)(M) tells the Oversight Board what a fiscal plan must include. Though we're not here litigating over the fiscal plan, it's important to keep it in mind, because what 201(b)(1)(M) says is that you have to respect what the preexisting state law was in terms of the separateness of different entities within the territory and the territorial instrumentality relationships.

Then we've got 201(b)(1)(N). Here's where Congress says that same fiscal plan must "respect the relative lawful priorities or lawful liens, as may be applicable, in the Constitution, other laws" -- they're referring to Puerto Rico when they say other laws -- "or agreements of a covered territory of covered territorial instrumentality that were in effect prior to the date of enactment of PROMESA." That's not an indication from Congress that we want to preempt state law. It's the opposite indication.

And the best one -- I would say there's two more to come -- Section 407(a) of PROMESA, says, "In order to protect creditors" -- the title of the statute is called protection of creditors -- "while an oversight board for Puerto Rico is in existence, if any property of any territorial instrumentality of Puerto Rico" -- so if any property of COFINA -- "is transferred in violation of applicable law under which any creditor has a valid pledge or lien on such property, or which

deprives any such territorial instrumentality" -- again, that's COFINA -- "of property in violation of applicable law" -- the COFINA Enabling Act -- "that assures the transfer of such property to such territorial instrumentality for the benefit of its creditors" -- that's us -- "then the transferee shall be liable for the value of such property."

That's not an indication from Congress that they want to preempt state law. That's an admonition to everyone that we'd better respect Puerto Rico law, or else there's going to be liability.

The last point, your Honor, where will this litigation machine previously unknown to man or woman ultimately end up? We hope, and I know your Honor certainly hopes, it will be in a plan of adjustment.

Let's look at one of these critical criteria for confirming that plan of adjustment. Section 314(b)(6) of PROMESA says -- this is the alternative to what your Honor will remember from Chapter 11 cases, the best-interests-of-creditors test -- "The Court shall confirm the plan if the plan is feasible and in the best interests of creditors," and then Congress went on to define that here, "which shall require the court to consider whether available remedies under the nonbankruptcy laws and Constitution of the territory" -- that's Puerto Rico -- "would result in a greater recovery for the creditors than is provided by such plan."

We're not here arguing confirmation, your Honor. What I'm trying to suggest is that Congress in many ways made it abundantly clear, even though Justice Scalia said we didn't have to because there's a presumption against preemption, but just to be very careful, because we're imposing a new law here on a lot of creditors and a lot of property rights that were already granted, and said, We'd better look back and make sure we comply with Puerto Rico law. That's our answer to the Commonwealth parties in terms of whether the Bankruptcy Code or PROMESA preempt or displace state law.

What the Commonwealth agent does, though, your Honor, without citing anything, is he says that, Well, you know, Puerto Rico law is great, but it just provides the raw material for the Court to determine properly.

There are two reasons to put something in quotes, your Honor. One is where a court actually said it, and the other one is when you make up a phrase and you go like that with your hands. I searched, and I couldn't find a case that supports that quote.

Your Honor, what the GO Bondholders suggest is that if you allowed the Commonwealth to define property rights, that would improperly allow the Commonwealth to redefine the bankruptcy framework Congress imposed on it. Really? How do you square that with all the Supreme Court case law that says the exact opposite? There is no bankruptcy framework. They're

just making this up, this tension that they say exists. And in particular here, your Honor, and as you've heard in other contexts, here, we had preexisting claims, property rights, liens and the like. It would have raised patent -- patent -- on its face Fifth Amendment issues if Congress had tried to displace all state law that had been created and to pass a bankruptcy law for Puerto Rico mid-swing. They balanced that right by making it abundantly clear, in four or five or six places in PROMESA, to make sure we respect preexisting state law rights.

Let me turn next to the Retiree Committee. I hope I can get through all of these.

The Retiree Committee's suggestion that the federal interest is the Commonwealth's ability to have a fresh start overlooks the fact that, first of all, fresh start is not the only guiding principle in the Bankruptcy Code or in PROMESA. Respect for state law is also part of the federal policy. Regaining access to the capital markets so that Puerto Rico could one day stand on its own two feet is another federal policy, and frankly, it's one that seems pretty incompatible with the notion that Congress would vitiate property rights that were just created under Puerto Rico law.

Plus, your Honor, this argument that the fresh start is the guiding principle that should answer every decision proves too much. Wouldn't it enhance the Commonwealth's

ability to have a fresh start, just eliminate all debts for no consideration at all? Of course it would, but the generic fresh start policy is not how judges answer questions that come up in a bankruptcy case. The rights of creditors must be balanced. When the creditor is secured, you have to give an indubitable equivalent. Why? Why Put that albatross around the neck of the debtor if the fresh start policy was the guiding principle?

But you know what my favorite is? The biggest flaw in the fresh start motto that's advanced by the Retirees' Committee is the selective application of it. The Retirees' Committee is asking your Honor to consider a fresh start for their debtor because their debtor is more important than my debtor. That's an invitation for the Court to show favoritism to one of two competing debtors in a property dispute. That's not the role of an Article III court.

Then the Retirees' Committee pivots and says, Well, it's territory clause argument. The territory clause requires the COFINA Enabling Act to yield to federal law. That doesn't work either.

Yes, it is true. U.S. territories have been held to not have the same sovereignty as a state because of the territories clause. And yes, it's true that Congress, and I'm quoting from their brief, "may thus enable a territory's people to make large-scale choices about their own political

institutions and may grant a territory legislative power merely as extensive as those exercised by any state legislature, but it is all subject to Congress's right to revise, alter, or revoke it."

That's all great, but it's a nice hypothetical. The question assumes the answer in trying to decide it. Congress did not revise, alter, or revoke any rights of Puerto Rico in respect of creating property interests. We just went through all those statutes.

With that general background on federalism, your Honor, I'd like to turn, if I can, to some of the other Retiree Committee arguments.

First, they cite, Well, it wouldn't be property of COFINA because -- it would be property of the estate of the Commonwealth. That's a head scratcher, your Honor. As you know, Section 541 is not even included in PROMESA. Certainly the Commonwealth can't be invoking a concept of property of the estate when Congress chose not to do so.

The other one they cite is, the Retiree Committee says, Well, there's no present claim under the Bankruptcy Code to future taxes against the hypothetical merchant, or the customer, and thus, there was no asset to transfer, and thus, there's no property right. This one also leaves me scratching my head. Property under state law is not limited by what counts as a claim or a right to payment under bankruptcy law.

If that's true, if I've got a debtor that owns another company, the equity in that other company is not property of the first debtor, because equity is not a claim. Equity is not a right to payment. It's just equity. State law determines property rights.

See, I knew I was going to run short on time.

Your Honor, let me pivot quickly to the notion of the Commonwealth's ability to alter, replace, repeal the SUT and why it's irrelevant to ownership.

It's irrelevant for the reasons Mr. Yanez said, that ownership is determined by the text of the statute.

What the GOs and the Commonwealth agents are doing is they are taking a provision of the COFINA Enabling Act, Section 14(c) -- it's a long provision; it starts with the statement, "The Commonwealth of Puerto Rico hereby agrees and assures any person, firm or corporation," and then it goes on, basically that it will not interfere with COFINA's rights. And then ends with the last sentence of that long passage. It ends with, "No amendment to this title shall undermine any obligation or commitment of COFINA."

So what do they rely on? They honestly take what I would call the equivalent of a legal tweezers to this provision and try to pull out a proviso that was put in in order to ensure that additional protective language called a nonimpairment covenant would not be rendered unconstitutional,

and by reserving this power back to the Commonwealth, they claim, therefore, there's no property at all.

The remedies that COFINA and its bondholders will have against the Commonwealth if they do revoke or repeal the statute are outside the scope, but they certainly don't determine the property interest that were granted by statute.

Thank you, your Honor.

THE COURT: Thank you.

Mr. Dunne.

MR. DUNNE: Good morning, your Honor. May it pleas the Court, Dennis Dunne, from Milbank Tweed, on behalf of AMBAC Assurance Corporation.

AMBAC is the holder and insurer of approximately $1.35 billion in accreted value of senior bonds issued by COFINA. I was assigned two topics to cover today, and I think I'm about to commit two oral-argument footfaults. I'm going to call an audible and go off-script and, perhaps more recklessly, try to use Elmo, if that's possible, to try to have a textual analysis.

THE COURT: We are not set up to broadcast visuals outside of the courtroom, and Ms. Ng would have to come over and pull the Elmo out.

MR. DUNNE: I didn't know where he lived either.

THE COURT: He lives in the podium. You'd have to be describing what's on the Elmo for the benefit of those who

listen. Do you want it?

MR. DUNNE: Then I might as well just describe what I'm talking about. Everybody has the language in front of them. I'm going to pick up basically where Mr. Kirpalani left with respect to the substitutability point.

THE COURT: OK.

MR. DUNNE: We'd like to call everybody's attention to the proviso in Section 14(c) and want to make, at least eventually, I hope, a very textual argument as to why the COFINA side's argument is correct.

But before I do that, I want to point out what's obvious, and Mr. Kirpalani said this, that this is a right that's reserved to the Commonwealth. Whatever the scope of that proviso is, it doesn't affect whether or not the property has been effectively transferred. That's an argument that we've had in other contexts. What it does is, perhaps, be an inchoate right that's not yet exercised.

While we're talking about the property right being transferred, I do want to call the Court's attention to a pleading in a slightly different context, but the oversight board agreed with respect to the effective property transfer when it wrote, and I quote, "The law provides that the Commonwealth doesn't own certain taxes [SUT or substitutive tax] even though the Commonwealth legislates the taxes, collects the taxes and can repeal the taxes." That's in

paragraph 7 of the oversight board's opposition to the certification motion.

Turning back to the text of the proviso, your Honor I'd say that the Commonwealth parties would like to make an argument that the beginning of that proviso that says "the foregoing provisions do not limit the power of the Commonwealth to limit or restrain the nature of amount of such taxes or revenues" is a separate thought, and then you pick up thereafter, where it goes on to say, "or to substitute similar or comparable collateral by other taxes, fees, charges or other income" is a completely different concept.

Why do I think that's textually wrong?

When you go down two lines, when it says, "If, for the following fiscal years, the revenues projected by the secretary of the treasury from such substitutive tax, income, or collateral is equal or greater than the service of the debt," and it going on. The substitutive tax income and collateral refers back to the three components that preceded it.

What preceded it?

Taxes, other revenues, or collateral.

The way the Commonwealth parties read this language would basically render unnecessary and surplusage substitutive tax and substitutive income. Why? Because substitutive collateral alone would work, because collateral's already defined two lines up, where it says "collateral by other taxes,

fees, charges or income," meaning you can't substitute it with a firehouse. You've got to have another revenue stream, but they've already defined collateral. Their argument is they want you to believe they did it again, and it's just surplusage; it's just a referring back solely to the collateral.

I'd make one point, and I'm not going to get into the English versus Spanish debate, but I do want to point out this. Here, in my argument, we have taxes, revenues, collateral, and then when you repeat it three, four lines down, it's tax, income, collateral. If you go to the Spanish translation -- and I am not a Spanish speaker -- the original Spanish, I should say, they use the same three words. "Revenues, income" is denoted by one word, *ingresos*, in both cases. I don't know whether that means revenues or income, but whatever it is, it's the same, and so there's really no space between that.

Lastly, your Honor, I think that your Honor's construction of this proviso has to be read in conjunction with the language that went before it and was informed by the language that preceded it where the whole intent of this was not to hinder or impair the ability to pay the bonds. Yes, you could reduce it. Maybe there's excess SUT, but as long as there's a substitutive tax and a dedicated stream to pay it, then you haven't run afoul of the language. I think the textual reading shows that the Commonwealth's argument is false

and I will move on in the minutes I have.

THE COURT: The Commonwealth argument that you're refuting here is the argument that the Commonwealth can reduce or eliminate without having to true up by way of substitution as the substitution only applies to the specific substitution-specific subclause of that sentence of 14(c).

MR. DUNNE: You understand it precisely, your Honor

THE COURT: Thank you.

MR. DUNNE: Moving on quickly, in the remaining time, I wanted to talk about the Commonwealth movants' argument that the COFINA structure is an end run around the debt ceiling, an evasion of the debt ceiling, and therefore, it should be invalidated.

Your Honor has ruled that whether any COFINA bond issuance is or is it not violative of debt and without scope, but nevertheless, the Commonwealth movants use the potential for that as a basis for attacking COFINA and the structure.

For me, that requires Olympic-level gymnastics.

THE COURT: In this context, I think what I read th Commonwealth to be saying was that if it's a constitutional violation of such magnitude, then COFINA can't exist at all and if COFINA can't exist, it can't own anything, and therefore, it is within the scope as an ownership question.

MR. DUNNE: Correct. I believe that's right, your Honor.

The Commonwealth agent argues that Act 91 is unconstitutional not because, and I'll quote from their reply brief, "any particular bond issuance" but because it "allowed the Commonwealth to issue bonds through COFINA without impacting the debt limit." That's at page 29 of their reply brief.

Whether or not COFINA ever, in fact, issued bonds in violation of the debt ceiling is irrelevant, in our view, once they have established a hypothetical possibility that COFINA could have tripped a debt limit were their bonds included in the calculation of Commonwealth debt, inquiry's over, and "the legislation and all transactions thereunder are invalid."

For starters, let's talk about what the limits of that principle are. If the Court adopts that logic, it would be easy to see how numerous acts of a legislature could suffer a similar fate. Almost any economic legislation enacted by the Puerto Rico legislature could be subjected to that test, and it wouldn't matter how close or not a Commonwealth was to the debt limit at the time, because you could always hypothesize creation of enough debt, issuance of enough debt in the future to exceed the debt limit. But I think the Commonwealth's agent is actually saying something more categorical and potentially sly, which is the quote from that reply brief indicates it was not any bond issuance that created the infirmity but the simple fact that the structure allowed debt to be removed from the

debt limit calculation, regardless of whether the limit was ever subsequently hit.

Such a broadside to municipal bond financing is stunning, but I think it's completely mistaken here, and let me point out three reasons in the time I have why I think this argument fails.

First of all, COFINA was not created to make an end run around the Commonwealth calculation. It was created to allow access to cheaper financing, and in some of the briefs, it's clear that they got a lower interest rate than if there was Commonwealth-direct borrowings. The Commonwealth is not out of capacity to issue debt at the time. In Exhibit B to the Commonwealth agent's original complaint, they say it was probably 2009 before the debt limit was hit, even if you put all the COFINA debt onto the Commonwealth balance sheet, after three series of COFINA bonds were issued and before nine or ten series of GO bonds were issued.

Second, the PR Constitution contains no provision precluding the dedication of future tax revenue streams to particular bonds or public corporations. Such anti-dedication provisions exist in other state constitutions, such as Alaska and Georgia. This Court should not rewrite the Puerto Rico Constitution to include one.

Third, the Puerto Rico Constitute expressly compensates debt being issued by public corporations and

expressly provides such debt shall not be counted against the debt limit. In the briefs, there's a footnote saying there's actually a senator who argued, We can't do that. We should count all the public corp. debt as Commonwealth debt so we make sure that we don't have too much aggregate debt. That did not pass. It was not adopted. Your Honor should not move against the will of the framers of that Constitution.

THE COURT: I'm going to give you a couple seconds to answer this and to make your last point.

MR. DUNNE: OK.

THE COURT: That footnote makes that statement abou that piece of legislative history that's not pointed to in the footnote, and in my searching through the forest, I couldn't find it as an exhibit. Do you know offhand where that is, or will somebody write me a letter afterward with the specific citation to that legislative history?

Somebody raise your hand if you can undertake to do that.

MR. DUNNE: We can write it.

THE COURT: Thank you.

MR. DUNNE: Your Honor, last point, and this is an ACT-specific point, we cite an Indiana Supreme Court case, the *Hawkins v. City of Greenfield* case, for the notion that you do not look behind the express intent of the legislature. You do not look through the form to some underlying, platonic

conclusion of substance.

In response, the Commonwealth agent cites a *Rappaport* decision, also from the Indiana Supreme Court. The only point I want to make on this is that the *Rappaport* decision predated the decision of the same court, the Indiana Supreme Court, that we cited by 20 years, and the *Hawkins* case notes the criticism of *Rappaport* and says that fortunately, the well-reasoned decisions of most Indiana courts refuse to extend *Rappaport* and the application of the debt limitation to prohibit the creation of new divisions or the financing of public projects through tax assessments.

In essence, the case that the Commonwealth movants cite is of no vitality even in the jurisdiction for which they cite it, in Indiana, because 20 years later, the *Hawkins* court cabined it tightly to the facts. And their facts were reasoned, it's just that that reasoning was overbroad.

Thank you, your Honor.

THE COURT: Thank you, Mr. Dunne.

Mr. Mayer, for summary judgment.

MR. MAYER: Thank you, your Honor. Tom Mayer for the Mutual Fund Group.

First, with respect to the timing of the transfer, your Honor, the only question is, What does Puerto Rico law provide and what can Puerto Rico law provide? All of this new tax stuff is an invitation to this Court to create a federal

common law issue, which I submit has no place in this proceeding.

With respect to any application of PROMESA to the question of when the transfer occurred or what was transferred, I join in the other counsel who say that you cannot retroactively take away COFINA's interest in the SUT that it has in the Commonwealth, and you can't retroactively take away the bondholders' interests in revenues that were pledged to the bonds without violating the Fifth and Fourteenth Amendments, and I note in this connection that the Retirees' Committee, in their reply brief, made reference to Section 552 of the Bankruptcy Code.

Your Honor, we moved for declaratory judgment that 552 could not apply, and that cause of action was struck as outside the scope, so I submit that any attempt to create a decision today using Section 552 is outside the scope of this hearing. We repeat our observation that 552, like any other provision of PROMESA, cannot be applied retroactively to destroy property rights that were created under Puerto Rican law. And again, it's only a question of what does Puerto Rico law provide, and what can Puerto Rico law provide?

I know that your Honor knows, and this is for, I guess, two weeks from today, we have taken the position that those questions are best answered by the Supreme Court of Puerto Rico, but I will move to a final point.

The Retirees' Committee and others make a big deal of the fresh start principle, and Mr. Kirpalani has already addressed that issue. I want to amplify it with the closing remark of Mr. Yanez. He said any transfer might be undone. You're putting the legislature in a position where any transfer might be undone.

Your Honor, I've looked through PROMESA fairly carefully, and I can't find the words "fresh start," but I can find the words "access to capital markets" in five places. I can find them in Section 101(a), where it is the first purpose of the Oversight Board, and I can find them in Section 201(a) where it is the first purpose of a fiscal plan, and I can find them in Section 209. It is the last duty of the Oversight Board, to obtain access to the capital markets.

Your Honor, when you fly to Puerto Rico, you land at Luis Munoz Marin International Airport. That was sold. That was a transfer. Revenues from that airport, those were available revenues. I realize that's a thing, and you have already asked what the difference is between a thing and an inchoate stream of taxes. Given practice in other states, I don't think there is a difference, and I don't see why there is any federal common law principle that prevents a state legislature or a Commonwealth's legislature from enacting a law to transfer the property. But if you strike down COFINA on the ground that it couldn't happen, you're putting Puerto Rico in a

situation where it will not regain access to the capital markets for probably the professional lifetimes of the people in this court, because nobody's going to lend Puerto Rico money unless it's backed by a stream of revenues that are committed to the repayment of the debt.

With that, I reserve the balance of my time.

THE COURT: You're reserving it for rebuttal?

MR. MAYER: Yes, I reserve for rebuttal, and I may very well yield it back to other members of the COFINA side.

Thank you, your Honor.

THE COURT: You have two minutes and 45 seconds out there, in the bank.

MR. MAYER: Thank you.

THE COURT: OK.

We now turn to the Commonwealth's interest, Mr. Stancil, for 33 minutes.

MR. STANCIL: Yes.

Good morning, your Honor, and may it please the Court, my name is Mark Stancil from the firm of Robbins Russell, and I represent the Ad Hoc Group of General Obligation Bondholders. My counsel today are Mr. Luc Despins and James Bliss, from Paul Hastings, and Mr. Rich Levin, from Jenner & Block.

With the Court's indulgence, we've divided up the substantive issues to avoid duplication. I'm going to be addressing what we call the core constitutional issue, which

is, assuming for the moment that COFINA's creators intended to transfer the pledged sales taxes, did they have the constitutional authority to do so?

Mr. Despins will then address the nonconstitutional issue regarding whether Act 91, in fact, transferred ownership of those revenues to COFINA.

Time permitting, Mr. Bliss will address the balanced budget clause issue.

(Continued on next page)

MR. STANCIL: Mr. Levin will address the fresh start argument and I believe also the civil code issues that he has raised.

So, your Honor, if I may, let me begin by restating the constitutional question. I think it's fairly clear from the discussion thus far. Assuming for the moment that the legislature tried to do what the COFINA parties suggest, which is to irrevocably transfer the pledged sales taxes to COFINA, did they have the authority under Puerto Rico's Constitution to do that? The answer is no.

Article 6, section 8 gives the constitutional debt, what we often call the GOs, gives them an absolute first claim on all of the Commonwealth's available resources. As the COFINA parties would have it, available resources means whatever resources the legislature deems fit to make available. And that's wrong for three main reasons that I'd like to get to today.

First, the COFINA position defies the plain text of the available resources provision and the context in which it appears. I will walk through word by word of the text --

THE COURT: I will look forward to that.

MR. STANCIL: Thank you, your Honor.

Second, their position ignores the founder's stated intent to place the constitutional debt in "absolute first term" over "all of the resources of the government."

You didn't hear a thing about the drafting history in my colleague's presentation earlier today, but, again, I will walk through that in detail as well.

Third, and certainly not least, their position would eviscerate the interlocking protections in article 6. It attributes a fundamental level of incompetence to the drafters of Puerto Rico's Constitution to suggest that this web of protections for the people of Puerto Rico and constitutional debt holders are evaded with a simple step to the left by saying, whoops, we have transferred these future revenues, and I am going to get into why that would render this entire system effectively meaningless.

But, in short, article 6 was supposed to be an absolute commitment to constitutional debt holders. They want to turn it into an option to withhold resources fro constitutional debt holders, and it has these careful limitations on the amount of revenue that can be absolutely committed for debt service. They turn that into an unlimited license to commit an unlimited amount of resources irrevocably for an unlimited amount of debt. In short, it turns article 6 on its head.

I think it's helpful to maybe start by reading the text of article 6, section 8. That's the centerpiece of the entire constitutional scheme. It says: In case the available resources, including surplus, for any fiscal year are

insufficient to meet the appropriations paid for that year, interest on the public debt and amortization thereof shall first be paid and other disbursements shall thereafter be made in accordance with the order of priorities established by law.

Available resources has meaning under the Constitution. It can't be just assumed away that available means whatever the legislature says. And ultimately both the COFINA agent and the Senior Bondholder Coalition, I believe, everybody would reluctantly concede that the legislature doesn't get you to define the constitutional term available resources. This Court is charged with giving content to that term, as it would any other provision like, what does due process mean? What does a taking amount to?

THE COURT: Isn't it a fundamental political function of elected leaders to determine what resources are prioritized resources, determine the appropriate application of resources? Unless you are going to say that this first priority means that any time there is a shortfall everybody on the island necessarily starves, everything has to get shut down, and any money that was ever spent before somehow has to be clawed back and that's what a court can understand. How is the Court in a position to determine whether babies should eat or traffic lights should be on or houses should get to stand up before bondholders get paid? Those are important political distinctions.

MR. STANCIL: Your Honor, there are probably three different answers to that.

Let me start by first saying under the Constitution, if the Constitution is respected, it will never come to that precisely because of the debt limit, and we will get to that in a minute.

Your Honor is exactly right. It would be crazy, would it not, to think that you could give bondholders an unlimited check to come ahead of all other services of the government. But it doesn't follow from that that the bondholders identified in the Constitution do not come ahead of other expenditures.

And don't take my word for it. Take the word of the Puerto Rico legislature for 40, 50 years, until two summers ago when we started throwing out statutes. This is a statute. I apologize it is not in our briefs. It's in our complaint. I think this answers your Honor's question correctly. 23 L.P.R.A. 104(c) is the statutory order of priorities that is directly referenced in the Constitution. So that addresses your Honor's question, did they really mean to pay constitutional debt before public health, safety, and welfare? Yes, your Honor, they did.

If I may, I would read to you a few provisions from 104(c). It begins: In keeping with section 8, article 6 of the Constitution in Puerto Rico, the governor shall proceed according to the following priority rules in disbursement of

public funds when resources available for a fiscal year are insufficient to cover the appropriations made for that year. 1. Payment of interest and amortization related to public debt. 2 -- it's a little wordy. I'll paraphrase. 2. Commitments under legal contracts enforced. Court judgments, binding obligations to safeguard credit. 3. Order that disbursements be made for expenses under the allocations for recurrent expenditure related to (A) the preservation of public health (B) protection of persons and property (C) the public education programs (D) the public welfare programs (E) the payment of employer contributions to retirement systems and pension payments to individuals etc., etc.

THE COURT: I as a court should respect that legislatively determined list of priorities because you like that and that's not really offensive and you could sleep at night because babies are going to get fed. But, otherwise, I should ignore anything, any other judgment that the legislature made, and come up with some holistic concept of availability that was in the third branch?

MR. STANCIL: No, your Honor. That's not how it works. This is what we would say is absolute clear evidence of what the intent of the founding document means. I want to come back to the premise of your question.

THE COURT: This is a statute passed by the legislature.

MR. STANCIL: Yes. I will just come back to the first phrase of Section 23 L.P.R.A. 104(c) which says: In keeping with section 8, article 6, here is what we do. They recognize that that's what article 6 means.

Your Honor, let me take the premise, which is no one is taking anything out of the mouths of babies because we have a debt limit. And the reason we are here, in large part or in substantial part, is because COFINA was used as an end run around the debt limit and that's why the Commonwealth is facing choices that it should not have to face. If it had been respected, the Constitution had been respected and any commitments made for debt, absolute commitments made for debt were limited to 15 percent of their revenues, we would not be here.

THE COURT: But it doesn't say absolute commitments made for debt. It says absolute commitments made for direct obligations of the Commonwealth backed by the full faith and credit of the Commonwealth.

And we know from the cases that have been cited all over the place that there are different kinds of state constitutional provisions and there are constitutional provisions that require referenda or put caps on any kind of debt on the state at all. Could have been written that way. Wasn't written that way.

MR. STANCIL: Your Honor, I respectfully disagree that

available resources is as flexible as COFINA would have it.

THE COURT: You said that we wouldn't be in this problem but for violation of the debt limit, and so I think you've necessarily put the import of the debt limit on the table in that last sentence.

MR. STANCIL: I apologize. Absolutely. I think that makes a mockery of the debt limit. Let's focus on what the purpose of the debt limit was. So the debt limit implies by its terms the full faith and credit debt because, as I've just described in article 6, section 8, full faith and credit debt gets this absolute first priority. So, of course, you would want to limit the amount of such promise you can make.

The fiction of COFINA is that you can evade the central policy objective of the debt limit by transferring future revenues as opposed to merely promising future revenues. It would make a mockery. I think it would sort of ascribe an astonishing level of incompetence to the drafters of the constitutional debt limit to say yes, you are going to hold their feet to the fire and limit them to 15 percent if they are going to make this super full faith and credit promise. We will let you sell revenue before it even gets to the coffers.

THE COURT: I think I perceive the COFINA people, and they can tell me if I'm wrong on rebuttal, as saying that it's not the transfer that's the key magic with respect to the debt limit; it's that the COFINA statute not only doesn't say full

faith and credit; it says you look to a particular body of revenues, and there is no commitment to use the taxing powers to get something more to replace those revenues that are taken off the table. So the COFINA people seem to focus on it not being full faith and credit and not being a direct obligation.

MR. STANCIL: With respect, your Honor, their position is entirely question begging. They say the debt limit doesn't apply because it's not full faith and credit debt, but that skips over the question of whether the transferring in the first instance is consistent with the idea of the debt limit.

If we can take a step back. If the Commonwealth had -- grant my premise, which I understand your Honor is testing, but grant my premise that GO debt does have what the Constitution says, an absolute first claim on resources.

If we were facing only that, in any given year it would no more than 15 percent of their revenues over the average of the last two years when they issued the debt, but roughly 15 percent of the budget go to debt service. We would be facing --

THE COURT: For full faith and credit debt.

MR. STANCIL: Yes, your Honor. We would be facing fraction of the drain on the Commonwealth's resources had they respected that and not done an end run around.

Your Honor, if I could explain the way that this makes not just a mockery of section 2 of the debt limit but the rest

of article 6, Section 8. I would like to come back to the text because I promised you that I would deliver what available resources means.

Can we back up one section. Article 6, section 7. And then we will read article 6, Section 8. I think that will give full content to what available resources means

Section 7 tells the Commonwealth to balance its budget. It says: The appropriations made for any fiscal year shall not exceed the total resources, including available surplus estimated for said fiscal year unless the imposition of taxes is sufficient to cover said appropriations provided by law.

When they wanted to refer to total resources of the Commonwealth, they are referring there to estimated for the year. So 7 says, when you do your budget, look at what you expect to come in the door. And then section 8 says, well, if it turns out what comes in the door are insufficient, the available resources, then I think in context those two provisions made clear when the drafter said available resources, they meant everything that comes in the door. I am going to tell you what the drafters meant because I can -- you haven't heard anything about it, but they gave us a contemporaneous and retrospective explanation of what they meant.

THE COURT: You're reading the balanced budget clause

in its Spanish incarnation, and you are comfortable with that.

MR. STANCIL: In this particular context we have not -- yes is the direct answer to your question. I'll move on. We do not raise the UCC's balanced budget clause argument.

Section 7 talks about total resources estimated for such a year. Section 8 says, what do you do if available resources are insufficient? I think read in tandem those two are very clear what they meant by available resources. Available is every bit that comes in that year through the Commonwealth taxing power.

Let me jump back again to section 7 because the word available is there as well. Total resources including available surplus. No one is suggesting that when they are budgeting under section 7 that they are looking at some parts of surplus that may be left over. But they can take part of that out. This is consistent meaning given to the constitutional term available. They meant it to apply to what actually comes in the door by virtue of the Commonwealth's activities and taxing power.

I promise that we would find out what the drafters meant. They don't really have an answer to this. Let's start with former Chief Justice Trias Monge, who is a delegate to the Puerto Rico constitutional convention. He was a chief justice in the Supreme Court of Puerto Rico. He was sort of a Madison and Hamilton kind of rolled into one.

He wrote in 1982 a report basically saying, here is what went on when we drafted the Constitution, and he talks about article 6. He says that the purpose of article 6, Section 8 was -- he says: The provision finally adopted by the convention placed in absolute first term and beyond the scope of the power of the governor the payment of interests and the amortization of the public debt.

With respect, your Honor, he did mean exactly what we said when he said, yes, it really is absolutely first. If you can sell future revenues for future years ahead of time, that's not an absolute first term.

Again, in 1961 --

THE COURT: I would just like to go back to Mr. Mayer's airport illustration. They sold the airport, got a bunch of money for it and, of course, there are landing fees, there are all sorts of things, there are subleases generated by the airport. Under your theory do we have to undo and look back through that transaction as well? Commonwealth keeps the money it got through the airport but can go and get the rent from Burger King and the candy stand and the duty free because those should be available resources of the Commonwealth that should have never been alienated?

MR. STANCIL: No, your Honor, we don't need to get into any of that and let me tell you why. When you are selling a physical asset, there is no question that legislature has the

authority to sell a physical asset as opposed to future tax revenues, and we know this in part from, again, Tria Monge. He actually was explaining what recurso, the Spanish term, means in the Jones Act, which predated the Constitution. The reference was made to ingresos, which it was just translated to mean only taxes or only sort of income stream.

He explained that resources is actually a broader concept, but then he clarified and this goes directly to your Honor's question. He clarified that physical assets and tangible assets are not subject to the claim but if you monetize them, you sell them, then those cash and cash equivalents are.

Your Honor, I think this is a very, with respect to Mr. Mayer, easy case. The tax revenues are at the core of what available resources are. In fact, I think the corollary of his position is far more untenable. He would say, well, we can sell anything and everything we need to, and we can hive off every sliver of tax revenue and create a special entity or special fund.

The case that we cite from Ohio, *Shkurti*, addresses this directly. That was an attempt to set up a special fund to take on debt, in effect. And the Court said, you just can't set up a special fund for this and special fund for that because there is no end to it. And COFINA is actually a painful illustration of that process. COFINA started as a

little $300 million bridge loan, in effect. We are now $16 billion into this and there is no end in sight.

For all of the sort of, we would say, irrelevant equitable arguments about how this was cheap and we needed it and it's easy and we might need it going forward, the worst thing, with respect, your Honor, that could be done for the Commonwealth is to give them a blank check, and that is exactly what COFINA is because it is limitless, absolutely limitless. And we are told that, well, both parties voted for it and everybody seemed to like it. That's exactly when constitutional provisions are most important.

Mr. Yanez referred to the political process being the check. Not when it comes to the Constitution. The things that we put into a Constitution are those things primarily that we don't trust the political process to address, and that is I think especially true with respect to debt, because it's very popular to borrow money and push your problems down the road, which is why, for example, back to the interlocking protections, article 6 has a 30-year maturity limit on full faith and credit debt. COFINA maturities extend out 40 years because you just push out, push out, push out your problems, and you don't ever get the fiscal responsibility that is essential.

If I may, can I come back to the drafting history. In 1961, Puerto Rico adopted the debt limit and in the course of

that discussion they addressed what they meant by available resources, and when they are referring to available resources, they said, the truth is -- this is Exhibit 1 to our summary judgment motion, which is docket 311 at page 4. The truth is that per the terms of the referenced constitutional provision, referring to article 6, all of the resources of the government are committed to those obligations that refer to the full faith and credit debt. And this is critical as well. They didn't think that was some formalist ruling that could easily be sidestepped. They said, we are not worried about increasing the debt limit because Puerto Rico has done a good job paying its bills. The good judgment that it has exercised in contracting the public debt and in not using subterfuges to evade the limits imposed on it, that was responsible for COFINA's good credit. With respect, your Honor, COFINA is exactly the kind of subterfuge they would not have countenanced.

We heard a lot about public corporation debt. This will spill over into other municipal markets or this will limit the Commonwealth's ability to commit some resources to debt for public corporations. Your Honor, I'm sure, is well familiar with the clawbacks and everything else that's in this case. I think the record is crystal clear that that has nothing to do with the available resources pledge. If I may, your Honor, again, the drafting history is absolutely clear.

When they were referring to public corporation debt not counting against the debt limit, there is a reason why and my adversaries don't want to talk about it, if you will indulge me one more time. This is on page 221 of the 1961 Senate report in connection with the debt limit. That's also Exhibit 1 to our motion for summary judgment.

When discussing revenue bonds, it should be clarified that the bonds issued and to be issued by the public corporations of the Commonwealth of Puerto Rico will not be taken into account when calculating the state's borrowing margin. That's where they want to stop. I am going to keep going. Since, for the payment of the same, the good faith of the people of Puerto Rico is not committed, and they will continue to be paid only from the income derived by said corporations. The reason that they don't count for debt limit purposes is they get their own money. COFINA tries to take the Commonwealth's money and scoop it into public corporations. No one thought that made any sense under the debt limit. There is another provision.

THE COURT: And COFINA relies on the full faith and credit reference and says that the defendant's revenue is sort of surplusage.

MR. STANCIL: The word is and, your Honor. That is their position, but it's completely untenable with that excerpt.

But I've got another one. When they were adopting the debt limit they had to go to Congress and get permission. So there is a hearing before the subcommittee on territorial and insular affairs. This is Exhibit 19 to our summary judgment reply. It says there: All the general government investments in schools, roads, everything is done by the Commonwealth and is included in this limitation. The only other thing are the municipal bonds and they occurred in small amounts, which greets the marketplaces. They were very limited in scope.

Here is the quote. And the others that we have are the public corporations, but those are revenue bonds. They are not sustained from taxes. Again, I think it's very clear. I think it makes perfect sense.

What is essence of COFINA, the reason that they are here saying this is their property? It's because they believe it to be irrevocably given to them. They believe it to be theirs and no one can take it away. Let's assume that it is right. It's inconsistent to think that the framers put this elaborate framework in place to protect the people from full faith and credit debt, too much good threatened the people of Puerto Rico. Too much would delay hard financial choices in times of shortfall. But they left this loophole. Started at 300 million. It's now 16 billion. By the time COFINA is paid off, if it is paid off, it will be 50 billion plus more of the Commonwealth's resources gone. I think it attributes a sudden

incompetence to think that he would leave a loophole this big.

They say, there is nothing in the text that says we can't do it. Well, that's not the way courts interpret Constitutions. Let me give you a couple of examples. The first is actually from the Puerto Rico Supreme Court itself. This is a provision in the Puerto Rico Constitution that prohibits the government from giving support to private schools. Well, Puerto Rico tried to get around that by giving support to private school students. This case is called *Asociacion de Maestros de Puerto Rico v. Torres*, 137 D.P.R. 528 (1994). That case appears in the COFINA agent's motion for summary judgment at page 24 for a different proposition.

But the Supreme Court of Puerto Rico rejected this attempt to dodge the prohibition on supporting private schools by supporting private students, and they said that the statute ingeniously tries to sidestep the constitutional obstacles by reframing from schools to students. It rejected that and said that is inconsistent with the framer's intent.

They talk about other states. Other states reject end runs like this all the time. The case from Indiana, *Cerajewski*, is a great example. There was a debt limit on municipalities limited to 2 percent of their property values and a municipality was up against that limit. So the state created a new district to build a vocational school in that district. The Indiana Supreme Court rejected that end run and

said, that just isn't the way that it works.

Your Honor, again to the surrendering of the taxing power, as your Honor has noted, I don't think the COFINA parties can have it both ways. The Constitution either prevents the Commonwealth from giving away the taxing power or it doesn't. They want to say, well, it doesn't prevent them from giving us an irrevocable right to the taxes that have to be kept in place forever and ever and ever. But that doesn't amount to a surrender of the taxing power. Respectfully, your Honor, I don't think that can be.

There is also a lot of attention paid to what they call either the deference or the idea that there is economic legislation so our hands are up. That's not right. Mr. Yanez actually referred, I think he said the more specific provisions that we are talking about in article 6 do not limit the more general provisions of the taxing power and authority and police powers. That's exactly backwards. This specific does limit the general. That is 101 statutory and constitutional interpretation.

I believe, your Honor, may I add back my extra minutes unless the Court has questions? May I do the same and put them in for rebuttal?

THE COURT: I do have a question which you may feel you've already answered, but I'd like you to take it up directly, which is, in looking for sort of core fundamentals of

the requirements of the various statutes, I'd like to go back to the debt limit.

At some point don't we have to be able to tie your core fundamental argument to the language that the framers used in the constitutional provision and in that constitutional provision the framers specifically said, direct debt, full faith and credit, obligation of the Commonwealth. And if you look through and you look at COFINA, I don't see any of those three things. How do I find, without rewriting the Constitution or deciding what mistakes I believe the framers should not have made, how do I find a constitutional violation?

MR. STANCIL: Because, your Honor, you read constitutional provisions, like statutory provisions, in harmony. And the debt limit, when it refers to full faith and credit debt, understands, the premise is that full faith and credit debt owns a first claim on all available resources.

So the textual hook, if you will, is the definition and meaning of all available resources, which is why the drafters say all. When they say in the debt limit, you've promised in your full faith and credit debt, you've promised all available resources, so I am going to limit how much you can issue, it would ignore the commitment of all available resources to assume that they can alienate those resources.

THE COURT: I then have to read into the definition of resource every single tax revenue, every single product of the

exercise of the taxing power.

MR. STANCIL: By the Commonwealth, your Honor. You don't have to read that into it. That's in the drafting history itself.

THE COURT: But it's not in the text --

MR. STANCIL: They didn't have any trouble interpreting resources when they are budgeting. They understand when they are estimating how to do their budget they look at everything they expect to get from all sources. So we wouldn't read into the balanced budget provision in section 7, for example, the ability of the legislature to say, well, this doesn't count and that doesn't count and this doesn't count and that doesn't count. The terms have meaning. They have consistent meaning across each of these provisions. So I think it is clear from section 7, section 8. It pops up again as sort of a distraction, it pops up again in section 19 with respect to delinquents. And the COFINA senior bondholders seem to think that helps them somehow that section 19 refers to the limits of available resources being a limit on how much provision can be made for delinquents.

With respect, your Honor, each time this appears, the word available resources, it means, in context, everything that comes in and that's the only way to honor the intent of the drafters who said, this is an absolute first term. There is nothing absolute if it depends on the discretion of the

legislature taken away. Absolute first term.

If we were reading the federalist papers, I think we would be up here making the same exact point and it's exactly the same and it worked for 50 plus years. In fact, if we go back to the 104(c) statute I was referencing, everybody understood this is how it worked. First means first and it is strange, very strange, to think that when they read the Constitution from 1952 up through 2006, they understood one category of debt, one and one only, was the head of the central services of public health, safety, and welfare. But in 2006 they decided, there is actually another thing we can do, which is we can sell revenues and now we are going to make that senior to GOs, which are, in turn, senior to everything else. I think that is just not consistent with common sense and obvious intent of the framers.

THE COURT: Your bondholder clients who bought afte COFINA was in existence bought under documentation that said and, by the way, on this COFINA stuff it's not going to be available to you. The proceeds of the COFINA bond offerings went to the Commonwealth. And if the Commonwealth legislature did overstep its bounds and do something unconstitutional, why is it the right result that people whose claims are against the Commonwealth get the benefit of the old debt having been paid off with the proceeds of that bond offering and the COFINA bondholders who bought something they thought was secure should

be the ones who take the hit.

MR. STANCIL: There is, I think, three different points.

THE COURT: Probably.

MR. STANCIL: No. 1, we are not here today to determine what kind of hit they take. Your Honor has ruled that what kind of post-property claims they may or may not have against the Commonwealth are beyond the scope of this proceeding. That would be my answer if I were allowed to get into it, your Honor. We could talk about what they may have and what they don't have as property. They can't create a power for the legislature by relying on something.

To that reliance question,, which I think is the second thing embedded in your Honor's question, what they relied on was a gamble, and the opinion letters they rely on say it's a gamble. They all say, no one knows for sure how this is going to come out. We think you will win. This is not the kind of thing where they have an ironclad assurance. They took this on a bet and betting on something does not make it illegal. Third, your Honor, it is not correct to assume that all of my clients bought after COFINA. There is a legacy GO debt --

THE COURT: I said those of your clients who bought after COFINA.

MR. STANCIL: Even those who did, your Honor, doesn't

change the rights they have under the Constitution. You cannot by a prospectus or even by legislation change the authority of the legislature. It didn't have the power to transfer away their tax revenues.

Thank you, your Honor

MR. DEPSINS: Your Honor, I'm next. Is it possible to take a short recess?

THE COURT: All right. We will resume in 15 minutes.

(Recess)

THE COURT: Mr. Despins.

MR. DESPINS: Good morning, your Honor, Luc Despins from Paul Hastings on behalf of The Official Committee of Unsecured Creditors in its capacity as the Commonwealth agent in the Commonwealth COFINA dispute.

Your Honor, I will address the nonconstitutional issues that are raised in the summary judgment briefing. If the time permits, Mr. Bliss, my partner, will address the balanced budget clause.

First, a bit of background. It's important to understand that what's at stake here is billions of dollars of future SUT revenues, and that goes on until at least 2057, if not longer. That's another thing to understand. There is no time limit to this. It goes on until the bonds are paid in full.

It's very clear from a bunch of things that I will

describe in a second that at the time this law was formulated, proposed, that the GDB and its advisors who were really drafting this were struggling mightily to deal with the constitutional issues raised by this structure.

The COFINA statute is really an attempt to reconcile goals that cannot be reconciled. On the one hand, they wanted to sell bonds badly. They were running out of cash They needed to sell bonds and the only way to really sell bonds was to make or attempt to make this as remote from the Commonwealth as possible. At the same time, however, they knew that GOs would complain about this, so they attempted to address the GO's future concerns regarding the constitutionality.

So they created an entity called COFINA that is purportedly independent of the Commonwealth. They said, create this. It's independent. Does it float in the ether, how does it work? Well, somebody said, it's attached to the GDB, whatever that means. And then they say, well, who is going to run this entity? They said, well, the directors of GDB will be the directors of COFINA. But of course the directors of GDB are appointed by the governor. So at the end of the day the governor controls the entire structure.

And they drafted language that purports to transfer SUT revenues, including future SUT revenues, until the bonds are paid. As we show in our papers, the language is not as clear as the other side would want it to be. I will address

that in a minute, your Honor.

But the drafter also added a provision stating that Act 91 shall not be interpreted or applied in a manner that would undermine the power of the legislature to impose and collect taxes. Of course, implicit in that, if you have the power to impose and collect, you have the power to not impose or impose less or substitutive a tax. That's why they had to add this provision, which we called the "turning off the tap" provision that I will describe in a second.

In addition to this language, he put in language purporting to render the SUT revenue unavailable to the Commonwealth. But then they also added a provision saying that nothing in the statute shall be interpreted in a manner that would undermine the rights of the GO bondholders. Go figure what they were trying to do other than trying to appease the bondholders somehow so they could point to a section that says, don't worry, this cannot be interpreted in a way that affects you. Honestly, it did.

Obviously, not all these provisions are consistent. There is a push and a pull going on in that statute and that really we call it at the office this Frankenstein statute because it is a compromise where a lot of things could not be compromised. They attempted to serve two masters and they didn't serve either of them well. That's the first point.

The second point is that the Court needs to confron

the fact that Act 91 is not a law that deals generally with a regulation of conduct like highway act or with property interests generally, like a statute of fraud or something like that. It is a special purpose law that created a financing structure solely to effectuate this transaction through the government and the bondholders. This is a pure special-purpose statute only to achieve this commercial financing transaction. Therefore, Act 91 is not somehow immune from the Court looking at the entirety of the statute, and we are going to go through that and the same time looking at the substance, economic realities of the transaction that is reflected in the statute and concluding that what was created here was, at best, for the COFINA side of the house a financing.

THE COURT: The legislature has the power to pass laws and, as you say, it passes different types of laws. And the general principle of statutory construction is that you apply the language of the statute that the legislature used. Are you saying that this type of statute is entitled to less respect or less deference in that way just because the legislature was making something really special?

MR. DEPSINS: No. I think the point is that -- and we will get to that in a minute. In the bankruptcy context it's important to not be stuck on labels. We have look at the entire statute. And I think we are going to go through that and I think we are happy to start working on the four corners

of the statute and show you how it leads to absurd results if their interpretation of the statute is adopted.

The point I wanted to make is that if statutes governing bond issuance was somewhat immune from a review of what is happening there, that would be kind of a nifty trick. Let's use this example. Your Honor knows me enough at this point that I often use examples that are exaggerated to make a point. This is one of them. The point is that let's assume a municipality wanted to borrow money now. No ownership issue. It's a clear loan, secured by a facility that a municipality owns. Let's assume that that statute that authorizes this said, in the event of a bankruptcy of this municipality, this collateral shall be the property of the bondholders. Would the court say, well, that settles it, I guess we can go home? We have the answer in the statute. The answer to the question is to answer it of course not. And that is an extreme example.

Let me give you a closer example. In a case that we don't cite in our papers, but that we circulated to our colleagues yesterday. The case of Orange County, which the cite is 191 B.R. 1005. The Court was confronted with the following fact pattern. Orange County had to receive funds from other governmental entities in California. Actually, these entities had to give money to Orange County so it could pool the resources and invest it with some brokerage firm, and they did that.

And when they filed for bankruptcy, the argument wa made by Orange County that, well, these funds were commingled. There is some of my money, there is some of your money. It's all in a pot and you are an unsecured creditor, speaking of the other entities at this point.

The argument that was raised, your Honor, is that a law had been passed, the very clear law in California that said that if a public entity was required by law to deposit funds in a county treasury, like Orange County, when it makes a deposit, those funds shall be deemed to be held in trust by the county. The funds shall not be deemed funds or assets of the county and the relationship of the depositing entity or public official in the county shall not be one of debtor creditor. Again, very clear statute. Sounds almost like COFINA.

Of course, the Court, in looking at this, the bankruptcy court said, you must be kidding me. We are not going to allow states to define the priorities in the bankruptcy case in the court that said that basically this statute would be ignored if it led to the result that these other government entities did not have to jump through the hoops that other creditors would have to jump through in a bankruptcy case.

So this is really what we are saying, your Honor, i that when the Court applies a similar standard, including the standards that have been applied in the First Circuit, in

looking beyond the labels and the beyond the substance, the Court will conclude that, at most, this is a secured financing; again, at most from the point of view from the COFINA side. That means that the SUT is owned by the Commonwealth.

To use an overused expression. If it quacks a financing and walks like a financing, it is a financing.

THE COURT: What Commonwealth obligation is secured by the pledged SUT? What is the transaction that's being secured? Because you have a payoff of the Commonwealth debt that was outstanding at the time and then there is a relationship between COFINA and the bondholders. Are you piercing the COFINA veil? What are you doing?

MR. DEPSINS: I think that's addressed in our brief and I don't have all the details committed to memory.

THE COURT: Neither do I. That's why I'm asking.

MR. DEPSINS: There is at least two theories and on of them is that this is a dry pledge, essentially, is that we are pledging our SUT to obtain the money that was used to pay our debts. That's all addressed in the opening brief, and I'll address that when I do the reply, your Honor.

Basically, going back to the statute, the only sensible reading of the statute is that the transfer occurs when the color TV, if you will, is sold and the tax is collected.

There are many reasons for that. One is, that's th

earliest. Practically, our position is that this needs to happen only when the tax fee is collected and it's put in the account. The reason for that is that what happens if the merchant goes bankrupt or doesn't pay? Under the statute, if it were to happen at the moment of sale, that property would be deemed owned by COFINA. It makes no sense. It's only when the money is put in the account.

THE COURT: Which account?

MR. DEPSINS: Until it hits the pure COFINA account, I don't think there is a transfer, your Honor, to COFINA. You know, and you probably saw this from the Banco Popular declaration, in fact, all the funds, the collected SUT, go first through an account today that is the name of the Commonwealth, and that started a few years ago.

THE COURT: I've read that declaration. But certainly in the real property context, even with bank accounts and community property, there is a concept that's respected in law of an undivided interest in a pooled asset or a jointly owned asset. Why isn't COFINA in there for at least whatever it is, 5 percent or 3 and a half percent, at the time of collection of the 100 percent of the tax? Why does it have to wait to be separated out?

MR. DEPSINS: The short answer, your Honor, is, we are not relying on that fact, meaning it's a fact that shows that we continue to have control. But we are not relying on the

mere deposit of an account to say that the ownership doesn't pass through. It's really one of the factors to show that we continue to have complete control over the SUT tax collection process.

But, your Honor, as you stated when the COFINA side was arguing, the concept that you can transfer ownership of an asset that doesn't exist doesn't work, and I want to give you some precise example in this statute of how it leads to absurd results.

Remember that there is a dispute between the Commonwealth side and the COFINA side as to whether there is an obligation if you turn off the tap, meaning the SUT tap, to provide substitutive collateral. You have heard about this before. Let's assume that they are correct. We don't believe they are, and I'll go through that in a minute. Let's assume they are correct. You know that this substitutive collateral must be deposited in the account, in the COFINA account. And their argument on the statute, the linchpin of the statute is, anything that must be deposited in that account is owned by COFINA going back to 2007.

I want to make sure we go granular on this. You have other collateral. Let's call it gold to make it easy that we want to substitutive collateral. We have to. Apparently, the Court had ruled that it's required if you want to turn off the tap. Putting that aside, we assume the most favorable facts to

them. That goal, if you will, would have been deemed owned by the COFINA side since 2007. That makes no sense whatsoever.

THE COURT: You are saying that they would be saying that not only the revenues but also anything that could potentially be substituted or might be substituted in the future is owned as of 2007, so there is too much.

MR. DEPSINS: That's my point. It leads to an absurd result. Their hook in the statute is what must be deposited. Whatever must be deposited in the account, their theory is it's owned by COFINA from day one. That is their theory and they are embracing it completely.

In the example I just gave you, it makes no sense whatsoever. This may have come from resources that have come up elsewhere and, all of a sudden, it's deemed owned back to 2007. It makes no sense.

Let me give you another example on how it leads to absurd results, their interpretation of the statute. You know that there is a topping-up requirement that if sales and use tax are not sufficient in any given year to pay the debt service on the bonds, the Commonwealth must make that up. It's a topping-up mechanism.

Same thing. This is coming from the Commonwealth's own seats, its own SUT. Under that theory, that SUT that it must now transfer is deemed owned retroactively to 2007. There is a lot that legislatures can put in and indeed transferring

and all that. It makes no sense, your Honor. These are just two examples of how this leads to an absurd result, if their interpretation is correct.

Let's assume for a second that they are right on everything, meaning that you could transfer the tax, that the statute did that, that my arguments are rejected. Actually this argument that they have, by the way, which is nowhere in the statute, that they have a pledge or a security interest or an ownership right in, quote, the right to receive, you will find that nowhere in the statute.

Let's assume they are right on that. The point is that that was not transferred. That ownership was not transferred. Why? Because the essence of this transaction, your Honor, is that there is no absolute transfer. And, yes, we are looking at true sale cases. You might say, I can do that in the statute.

The point is, we have made that point. Other courts have looked at the statutory scheme, have looked at it and said, that's a contractual relationship, and we are going to apply regular bankruptcy principles to that contractual relationship. The *Seven Counties* case. In that case the Court found that the statutory scheme created an executory contract which could be rejected. By the way, that's one of our out-of-scope claims. We are not going to argue it. But I want to make sure you recall that.

The point there is that it is OK, and they cite no case for the proposition. Their proposition is that when you have a statute you cannot apply these principles at all. So if you have a statute that governs the contractual relationship between parties and the example I gave, it's a clear loan. If it quacks like a loan, it walks like a loan, it's a clear loan, but the statute says it's owned by the other party, that you need to end your inquiry there. We don't believe that. We don't believe there is any case that says that. Then if you look at the merits of the argument, they don't even try to tackle us on that or touch us on that.

THE COURT: I'm sorry. This may seem elementary to you or elemental, but I'd like to go back to, if it's a loan and we have not blown COFINA into the ether via the constitutional arguments, not saying that won't happen, but hasn't happened yet, who is the borrower? Who is the lender, since COFINA is there right now and the Commonwealth has got all the money it's going to get out of this --

MR. DEPSINS: The Commonwealth, either through a dr pledge or otherwise, is a borrower and it pledged its SUT for that loan. That's addressed in our opening brief and I'll address that when we go -- I'll use my time on reply to address that because I know that there are two separate theories under which that works.

But the point, your Honor, is that if you look at the

statute, the risk, was there an absolute transfer? There was not. Why? Because of that topping-up mechanism. When you sell an asset, you don't remain liable to pay the difference to the lender. It's a sale. It shows that there is no sale here because we remain liable to make up the difference.

THE COURT: Shouldn't there be a sale and then a bonus contractual undertaking? Why does it have to invalidate all of the sale?

MR. DEPSINS: I am not sure I understand fully.

THE COURT: Why can't there be absolute transfer of the right to the revenues and, in addition, a payment of consideration for some contractual undertaking of the Commonwealth to come in, not committing its full faith and credit, but in some other capacity to do this topping up if there is a shortfall?

MR. DEPSINS: It's inconsistent with an outright transfer because it's not only the topping up, your Honor. It's the fact that we get it back once they get paid, which is another indicia, clear indicia that it's not a sale

THE COURT: It says that COFINA can give it back once it doesn't need it anymore. I don't think the statute says COFINA has to give it back.

MR. DEPSINS: Yes, your Honor. That's technically correct. But it also says that COFINA has only one role in life, which is to pay the bonds. It cannot go to Vegas and

spend that money. And, second, that's why it's important, the governor controls this anyway. Let's assume the bonds have all been paid. There is no way the Commonwealth is going to keep transferring SUT because there is no purpose in the life of COFINA other than to pay the bonds. It's a special purpose entity and it can only use the money to pay the bonds or pay its understood expenses. That's not an issue. And, therefore, at the end of the day, you see the full picture here. The SUT is just collateral for a loan. That's all it is because COFINA cannot get an upside of that. Let's assume that you only have to transfer SUT until 2055 to pay the bonds in full. There is no way that the SUT will continue to be paid in 2056 and 2057 because COFINA has no role, no existence other than to pay the bonds, and the governor controls it anyway. So it's really a nonissue. The point is that shows that the substance of this is that it's a loan.

Your Honor, I certainly resent the fact that they argue this is outrageous. They gave the money. Of course they gave the money. In bankruptcy, tons of people have given money and have not recovered on those loans.

More importantly, your Honor, is that it was well known to everyone. They rolled the dice on this. I want to be very clear about this. That's all in our brief, so I won't spend a lot of time.

But in 2006, there was a memo from the Fiddler law

firm that was part of the legislative history that was in that file and that basically says, the bondholders must know that the contractual obligation to them is subject to the fact that the legislature can eliminate the sales tax. We can turn off the tap. The bondholders need to know that.

By the way, that memo doesn't say, but don't worry, you will get substitutive collateral. It's completely silent on that. And we cite four or five of these, your Honor, in our brief, and we also cite to the official statement. This is the prospectus that was used to sell the COFINA bonds. It says: The legislative assembly may amend, modify, or repeal act No. 117. That's the statute that imposes the SUT. And that's listed not in a vacuum somewhere; it's listed under risk factors, your Honor, and this is all in our brief. These are exhibits to our brief.

The point is, everyone knew this. Nixon Peabody in its opinion says: Thus, the legislature is free at any time to reduce the rate of sales and use tax or eliminate it entirely. The opinion goes on to say, this has been clearly disclosed to bondholders. I am not going to go through all of them, but they all say, the bondholders can end up -- if this happens, they will end up with zero. None of these memos say, oh, by the way, you will get substitutive collateral.

Frankly, I have to say, I didn't follow at all the argument about why the substitutive collateral is required. We

addressed that in our brief extensively. But the word such substitutive collateral obviously refers to the second part of the proviso, not the first part.

And if that were not clear enough, your Honor, in the statements, the official statements of the COFINA bond offering -- we cited this at docket 347-18, Exhibit 10, page 22 -- they separated the two parts of the proviso so they put a one little I and a two little I. One little I we can reduce or repeal, whatever the language is, or, comma, two little I, provide substitutive collateral, which makes it crystal clear that the intent at that time was that these provisions had to be read in the disjunctive.

THE COURT: In determining ownership of the SUT for purposes of this proceeding and my scope order, do I need to resolve that issue with respect to the consequences of elimination or reduction of the SUT? And I am hereby inviting comment from COFINA about this on rebuttal, but first I'll ask you.

MR. DEPSINS: It is part of the crux of our argumen that the fact that you can do this, you can just turn off the tap, it's one of the crux of our argument as to why there is no ownership here, because you can't have ownership in something that has some sales and use tax that will occur in 2040 when the legislature could say in 2020, we are turning off the tap. That makes no sense. Whether you have to decide, whether that

can be done with any consequence, I'd like to reflect on that for a few minutes, and I'll come back and I'll reply to address that point.

The point, though, your Honor, as I made it before -- actually this one I didn't make. Let's assume that they are right, that you need to provide substitutive collateral. What does that say about ownership? I've already covered that. It's impossible for something that we don't even know what a substitutive collateral is. Could be gold, could be other things, new tax, whatever. We don't know what it is. That would be deemed to be owned because it must be deposited in the account. That's the operative words. They would be deemed to be owned back in 2007.

Then they say, this is bootstrapping to the extreme Hey, if you are doing that, you will have a constitutional takings claim. The point is, we cite cases in our brief that basically say, if the statute that grants you a right expressly says, I can take it away from you, that's the end of the inquiry. There is no constitutional taking. There is no --

THE COURT: I'm sorry. We need to stop for a minute because apparently the connection in Puerto Rico has gotten disturbed. Sorry. You can collect your thoughts for a minute. We are stopping the clock to find out what's going on.

(Pause)

THE COURT: You may continue.

MR. DEPSINS: Your Honor, their interpretation lead to absurd results, and we believe that that is why the Court should find that the transfer only occurs when the fund gets into the account. Otherwise, you can have this concept, which is unknown in any country, of floating ownership. It's not a floating lien. It's floating ownership. Basically, they have a lien against any asset that is required to pay them and that can't be the law.

The next item I want to talk about is the labels issue, the fact that when territory law -- because I might not going to say state law -- the territory law uses labels, that's not dispositive in a bankruptcy context. And the argument that they make is that that can't be because all the cases you are citing refer to property of the estate. That has to be so wrong.

First, it's wrong because you will see in the Orange County case the Court dispatched that because in chapter 9, same thing as PROMESA, there is no property of the estate concept, and the Court said, there is no way that's controlling.

But more importantly, the reason why there is no property of the estate is because if you had property of the estate there would be a section of the code, 363, that would say the debtor cannot use property outside your course of business without your Honor's permission. That's why there is

no property of the estate.

The PROMESA statute in 301 says property of the estate in a bankruptcy code shall be substituted for property of the debtor, and there are various provisions of the bankruptcy code that apply. For example, Section 1123(a)(5) says that a plan must deal with property of the estate. Of course in our case that means property of the debtor.

There is no evidence anywhere that Congress, when it deleted the concept of property estate in municipal cases or in the PROMESA statute, intended for these governments to have less rights than a corporate debtor as to what is property. There is no evidence on that whatsoever. So that argument needs to be rejected.

On the meat of the matter, the First Circuit and many other courts have said, when dealing with property of the estate, that we shall not be detained or we shall not be controlled by labels used by state statutes. For example, if the state statute says this asset is owned by the government because it's a privilege, it's not a property interest, courts have said no. It has value. It can be sold. It's proper in bankruptcy. And you've got the *Ground Round* case. You've got the Third Circuit case in *Christburger*. You have several other cases that say that. The First Circuit in *Gull Air*. And they all say that, your Honor. And that's what we are asking the Court to do, which is to look at what really is going on in the

statute and determine that and not be blinded by the fact that there is one section of the statute that says, we hereby transfer. By the way, we are not waiving arguments as to why that language doesn't do it for them. That's in all our briefs.

In the couple of points I'd like to make before concluding, your Honor, is, it's really the only legally possible interpretation of the statute that the transfer cannot occur in 2007 because the Commonwealth, who is the collecting party here, has no right under Commonwealth tax law to collect the tax until the transaction has occurred. That's in our brief.

Given that, how can the Commonwealth transfer rights into something that it has no rights in itself? It can only start doing that when the transaction has occurred, unless they were to pledge their right to receive, which the statute doesn't do and also it couldn't do -- not pledged. Transfer ownership of the right to receive because that would violate the Constitution.

Therefore, your Honor, for these reasons, we believe that the summary judgment should be granted. I just want to check for two seconds, your Honor.

THE COURT: After you deal with that, I have another question.

MR. DEPSINS: Basically it's on page 18 of our brief,

the answer to the question. I'll address that more fully during the rebuttal.

You had a question, your Honor.

THE COURT: Yes. You've criticized the substitutio theories and the concept as undermining the notion of a transfer of property and also takings inconsistent with the constitutional structure. Mr. Yanez said, well, maybe at the point of substitution, maybe it's damages for conversion, maybe it's damages for breach of contract, maybe it's compensation for a taking. But because it could be any of those three things it's not inconsistent with the notion that there was actual ownership of the taxes for which it was substituted.

Do you have some views on that conceptually and on the specifics of it that you would like to share?

MR. DEPSINS: I just don't see how there can be any claim of taking conversion and all that when the contract says, I'm giving you that right. And what that right is, we will put aside for a second and I can take it away from you at any time for any reason.

The courts are pretty clear on the constitutional takings claim that you have no takings claim in such a context. They rebut that by citing cases where the Court has said, the mere fact that the state has established a process for taking doesn't mean that it can take away the right. That's not what we are dealing with. The operative statute says, you don't

have that right if I say so. It is clear. I don't see how they could have any claim. If they had a claim for that, we will deal with that in part 2. Not that we are looking forward to that, but the point is, it shouldn't drive the decision of whether there is ownership here.

THE COURT: Thank you.

MR. DEPSINS: Thank you.

THE COURT: Mr. Levin for 12 minutes.

MR. LEVIN: Good afternoon, your Honor, if it pleas the Court, Richard Levin, Jenner & Block, for the Official Committee of Retirees.

Your Honor, given only limited time, so I am not going to review our entire argument. I would simply like to point to a few specific matters in our papers and respond to my questions that the Court might have.

The COFINA parties' principal argument, your Honor, is the legislature says so and that ends the debate. Well, as the Commonwealth agent and GOs have shown, the legislature didn't quite say so, and we cover this in our brief. The Enabling Act itself withholds the commitment that the COFINA parties argue, and the legislature has, in fact, amended the statute several times in a way that is inconsistent with the full transfer argument. We described that in our motion papers at 3 through 8 and 20 through 21. In other words, we need to watch what the legislature does, not what it says, and here what it did was

not transfer the revenues.

THE COURT: Give me a couple of examples because, as I said, unfortunately, I don't have a complete photographic memory of pages 3 through 8 and --

MR. LEVIN: Mr. Despins had already described how there was already rights withheld. But in 2013, rights were granted and then taken back. In 2007, actually, the transfer was redone because they felt the original transfer was somehow inadequate or improper. They didn't want it to go the way they said it did, so they moved it to a different entity

THE COURT: Thank you. Those are some examples.

MR. LEVIN: They are laid out in our brief in some detail.

In addition, the legislation must be interpreted in light of the general principles of Puerto Rico law set forth in Puerto Rico civil code, as we show in our motion. Again, I'll give you page references for future review since time here is limited. That's pages 12 through 16 and reply brief at 5 through 6.

The purported transfer has all of the attributes under the civil code of a pledge, not of a sale. Your Honor asked Mr. Despins, what obligation is the pledge securing? Well, the statute, Act 91, says that COFINA will transfer the bond proceeds to pay off the extra constitutional debt and, in exchange, the Commonwealth will transfer the SUT until such

time as the COFINA bonds are paid off, and then the Commonwealth -- it doesn't specifically say the Commonwealth may recover them. What it says is the negative. The Commonwealth may not take them back until the bonds are paid off. So it looks like the Commonwealth has an obligation to COFINA to give it enough money to pay off the COFINA loans in exchange for COFINA having paid off the extra constitutional debt of the Commonwealth and the Commonwealth they recover is collateral after those COFINA bonds are paid off.

Of course, the legislative assembly may amend the civil code and render it inapplicable, but in this case it didn't. All of the attributes look like the pledge in the civil code.

Now, even if the Enabling Act intended to transfer future SUT to COFINA, that transfer is unenforceable in this Title III case. So the future SUT remains property of the Commonwealth for two principal reasons.

The first reason is the bankruptcy law. As has been discussed, Congress has plenary authority over Puerto Rico under the territory clause. PROMESA is inactive under the territory clause. It says so specifically and Title III is a bankruptcy statute. It incorporates large portions of the bankruptcy law.

There is no issue of state sovereignty or of federal law overriding the law of a sovereign state in a federal dual

sovereignty system. This is not a dual sovereignty system here, so congressional dictates are viewed, one as against the other, not as against deference to state sovereignty.

But even in those cases where a state statute is involved, Congress can, under the bankruptcy code, under the bankruptcy power, override a transfer that would be valid and enforceable under state law.

THE COURT: As Mr. Kirpalani pointed out, PROMESA, this congressional statute, does very specifically speak to respecting territory law. It doesn't expressly say that all territory law and labels are out the window. So I'm hoping that you are going to acknowledge and sort of reconcile that aspect of this particular statute in this argument.

MR. LEVIN: Yes, your Honor, it does say that. Jus as Congress and the Supreme Court have said that state law typically governs in bankruptcy cases. But even the lead Supreme Court case on that, *Butner*, says state law governs property rights unless some federal interest requires a different result.

And in this case there is a very clear federal interest, the fresh start, which I know Mr. Mayer has said nowhere it is in the statute. It's nowhere in the bankruptcy code either. But it is in perhaps the leading Supreme Court case on bankruptcy and the discharge and it is important and that is *Local Loan v. Hunt*. In that case, state law expressly

preserved the property right of the transfer of future wages of the wage earner who was in bankruptcy, just as the COFINA parties argue that the COFINA Enabling Act does here, but against the contention that the Court was bound to follow the Illinois decisions since the question of an existence of the lien depended on Illinois law.

The Supreme Court ruled that contention, quote, is precluded by the clear and unmistakable policy of the Bankruptcy Act. And the Court rejected the Illinois decisions, quote, as being destructive of the purpose and spirit of the Bankruptcy Act, and that is a principle that Congress has embodied in all bankruptcy legislation since that time in 1934.

This is not the argument that one policy or the other policy is the better policy. This is an argument from the core of the bankruptcy law which Congress adopted in Title III of PROMESA.

Now, I think it was Mr. Kirpalani who said, well, that that's saying the fresh start for Commonwealth is more important for fresh start for COFINA. I'm not saying that at all. COFINA's fresh start doesn't provide a basis for overriding applicable law or denying the common law for fresh start.

The best way to illustrate this is let's assume when Mr. Hunt was going through the bankruptcy in the 1930s, the Local Loan company was as well. I don't think the Supreme

Court would have countenanced an argument that says, because Local Loan is going through bankruptcy, the wage assignment is effective against Mr. Hunt because Local Loan needs it for its fresh start. That is gathering property into the estate where the fresh start is about the discharge and the release from commitments that have been made.

Your Honor, if creditors could buy or a financing agency could buy all of a municipality's taxes, municipal bankruptcy would simply become unavailable. As we show when tracing the history of the 1988 municipal bankruptcy amendments which carved out only special remedy bonds, only very limited exception, Congress has not permitted the sale of future reference of a municipality to stand up against a bankruptcy petition or bankruptcy law.

The second reason, your Honor, I said that the transfer would be unenforceable is the taxing power itself. The taxing power is so central to the nature of government that even without an express constitutional reprovision it cannot be bartered or sold. Irrevocably transferring future taxes does that. The Supreme Court said as much in 1942, Justice Frankfurter in the case of *Faitoute Iron & Steel v. Asbury Park*. It was not based on any state constitutional provision that the Supreme Court ruled but on the very nature of government. Just as Frankfurter said, quote, the principal asset of a municipal is its taxing power and that, unlike an

asset of a private corporation or, I might add, an airport, cannot be available for distribution.

THE COURT: But the Commonwealth hasn't given away its taxing power. It's given away particular tax revenues and it still has the ability to impose new taxes, to raise taxes, to lower taxes, to do things with taxes. How is this a surrender of the taxing power?

MR. LEVIN: First, as Justice Frankfurter also recognized, the taxing power is not unlimited. There is a point at which taxes return less than the rate would imply because people simply can't pay that. We saw that in the Great Depression and that's why Congress enacted Chapter 9 to begin with.

In any event, if the COFINA parties are correct, that the tax cannot be modified without substituting something of equal or greater value, then the Commonwealth has given away that much of the taxing power. It has surrendered to the COFINA parties or to the COFINA entity and said, we can't touch it; or if you do, we have to replace it with some other tax, and taxing is not unlimited, so it is a surrender.

Your Honor, I want to add to that the concept that if the COFINA parties are right, if they are right that no matter what they are entitled to be paid by the SUT, by a substitute tax, by a claim for breach of contract, by a conversion claim, if they are entitled to that money from the Commonwealth, no

matter what, then the Commonwealth has pledged its full faith and credit. If the Commonwealth, as they have argued, has not pledged, then they are not entitled to that. We cite the Alabama case, the town of Georgiana, in our reply brief which goes through the mechanics of this, and it makes very clear that principal.

That is why we believe, your Honor, that the taxes have not been transferred in the way COFINA argues.

THE COURT: Thank you.

MR. LEVIN: Thank you, your Honor.

THE COURT: We will now turn to the rebuttal arguments. First up to Mr. Yanez for 10 minutes.

MR. YANEZ: Thank you, your Honor. For the record, Antonio Yanez on behalf of the COFINA agent.

Your Honor, Mr. Friedman, on behalf of National, has five minutes on rebuttal that he has just graciously agreed to cede to me. I think that brings my total to 15.

THE COURT: All right.

MR. YANEZ: Thank you, Judge.

Let me begin with the constitutional arguments. The underlying theme of those arguments which was stated explicitly at different times was that somehow COFINA was taking the Commonwealth's money or the SUT sales tax is the Commonwealth's money. That's wrong, your Honor. It is wrong for the straightforward reason that the pledged sales tax is money that

was transferred to COFINA in exchange, again, for $18 billion, $16 billion that became available resources as soon as they were passed over.

The General Obligation Bondholders also make the argument that it would be an act of stunning incompetence for the legislator to have left what is described by them as a loophole in the form of a constitutional debt provision that applies to full faith and credit debt but not to nonrecourse debt.

A response to that, Judge, is that it's not a loophole. It gives the legislature discretion. There are alternatives. There is full faith and credit debt and there is nonrecourse debt, and it leads to the legislature's discretion how those alternatives are going to be deployed. That is not irrational. It is not a stunning act of competence. It recognizes the centrality of the taxing and spending power in the hands of the legislature. It recognizes the primacy of the legislature with respect to taxation spending and economic matters and is a perfectly rational way to interpret the Puerto Rico Constitution.

On that subject, your Honor, in terms of how the analysis should proceed, listening to the General Obligation Bondholders, one would think that the starting point is the available resources clause, the debt priority clause of the Puerto Rico Constitution, that is the first order and that

everything else in the Puerto Rico Constitution flows from that.

That is exactly backwards, Judge. It's exactly backwards. The starting point is the taxing power. That is a broad power. It is a plenary power and has been recognized to be a plenary power by the Supreme Court of Puerto Rico and that is a power that resides with the legislative assembly.

So then the question becomes, given that the legislative assembly possesses this plenary power over taxation, are there specific provisions in the Puerto Rico Constitution that act to override or limit that plenary authority? That's the framework for analysis. We have articulated, all of us on the COFINA side, the reasons that we believe that the specific provisions relied upon here don't act to create such a constraint. I am not going to repeat the entirety of that.

I do just want to pause on one point, however, your Honor, and it is this. The General Obligation Bondholders rely upon the legislative history. They say that the legislative history is the place to go for the identification of the available resources clause, the debt priority clause, as a substantive constraint on the power of the legislature.

Judge, the materials that they rely upon don't say that the debt priority clause acts as a constraint on the power of the legislature. The materials that they rely upon say that

it acts as a constraint on the power of the governor. I'll be specific.

The constitutional history that they rely upon, including and principally the history of the Puerto Rico Constitution by Chief Justice Trias Monge, who I think was described as the combination of Hamilton and Madison, what that constitutional history says is that the debt priority clause was adopted to, quote, place in absolute first term and beyond the scope of the power of the governor, of the power of the governor, the payment of interest and the amortization of general obligation debt.

The question becomes, why does the governor's power have to be constrained? Isn't it the legislature that establishes what is to be spent and then the governor is required to follow that? The answer to that, Judge, is the dissenting opinion that the General Obligation Bondholders rely on in *Presidente de la Cámara v. Gobernador*. Again, they rely on that case as articulating a framework within which total resources are estimated at the beginning of the year and then at the end of the year there is consideration of what is available, what actually comes in.

What that case describes is in the constitutional budgeting process in Puerto Rico the governor has a line item veto that allows him or her to reduce, eliminate, and reprioritize appropriations. So the purpose of having a

constraint on the governor, at least based on the materials that the General Obligation Bondholders rely upon, is so that when the governor exercises his or her line item veto to ensure that that's done in a way that maintains the priority of general obligation debt.

The important point, Judge, is that the debt priority clause as a substantive constraint on the legislative assembly's taxing power is not in the legislative history, at least not what is cited or what is relied upon by the General Obligation Bondholders, and it is not, as I have said in the text of the debt priority clause, which should be the main consideration here.

Let me talk about evasion, your Honor. The General Obligation Bondholders referred to two cases on the subject of evasion and the fact that a constitutional provision can be evaded, even if its plain terms are not violated. That's not what those cases hold, Judge.

Those cases, and I'm talking about *Shkurti* and I'm talking about *Cerajewski*, those cases involved constitutional debt limitations that were much more explicit, much more precise, and much more restrictive than what we have at issue here.

I will be specific. In the *Cerajewski* case, there was a debt limit which prohibited borrowing by political corporations, quote, in the aggregate exceeding 2 percent of

the value of the property within that corporation. The issue there was whether two corporations could own the same property under that provision and not have it be exceeded.

So, too, in the *Shkurti* case. The provision at issue there said that subject to certain exceptions that don't apply here, quote, no debt whatever shall hereafter be created by or on behalf of the state. No debt whatever shall be created by or on behalf of the state.

Contrast that, your Honor, with the debt limitation that's at issue here, which applies, as I've said, only to direct obligations of the Commonwealth for money borrowed directly by the Commonwealth and backed by its full faith and credit. Those cases don't say that a constitutional provision can be evaded where the terms of the Constitution are not violated. They don't stand for that proposition, Judge.

Turning then to the subject of the transfer of the pledge to sales tax, Mr. Despins, sort of the baseline approach in his argument. he talked about different considerations. He talked about form versus substance. He talked about labels. He talked about statements in memoranda that may have been included in the legislative record.

What he didn't spend as much time, precious little in fact, was on the words of the statute. I am not going to belabor it because I know I have repeated them. But the words matter, Judge. Statutory interpretation, as I have said, and

as the First Circuit has said, in Puerto Rico begins and ends with the words of the statute. And the statute here say that there was a transfer and that the pledged sales tax shall be COFINA's property. Judge, the only way to conclude that there was not a transfer or that this is something other than COFINA's property is to ignore those words. That should not be the result. Under the controlling authority here it ought not be.

Still with respect to the subject of the transfer, Mr. Despins talked about absurd results, that there would be absurd results if the Court were to conclude that implemented sales taxes that have not yet been collected and had not been collected in 2007 were transferred to COFINA. The underlying premise there, Judge, is there was nothing to transfer. I mentioned this briefly when I was up here last.

That premise fails because there was an existing tax that required money to be remitted and the result was that a stream of revenue was created. Your Honor, the only way to conclude that there was nothing to transfer when the sales and use tax was implemented is to accept the fiction that nothing was ever going to be sold in Puerto Rico from that point forward because if something was going to be sold, and I would submit that is a fair assumption, if there were going to be sales, then there were going to be taxes collected and there was going to be, and there was, a new stream of revenue.

Mr. Despins says in one of his examples, how can yo have you taxes collected on the sale of an item that hasn't yet been sold and where the merchant might or might not exist down the road. The merchant might go bankrupt. The merchant might not be there.

Judge, those same types of criticisms can be leveled in every one of the municipal finance situations that we have cited to and, for that matter, in every one of the commercial situations that we have cited to. If I sell a stream of rent to someone with respect to a building that has 10 apartments in it, maybe all of those apartments are going to be sold, and that's what my buyer is going to get, or are going to be rented. Maybe fewer than all of them are going to be rented. Maybe one of them or two of them or three of them are going to be harmed in some way. Rents might go up. Rents might go down. There are a million variables.

If the point is that future revenues can be subject to variables, then we will agree with that. But if the point is that the fact that future revenues being subject to variables somehow makes them incapable of being transferred, that point is contradicted, your Honor, and it's contradicted by case after case after case.

And on this point, Judge, I would like to focus, too, on the specific cases that the Commonwealth agent in particular relies upon. Judge, their cases are about situations where a

court held that corn that has not yet been planted can't be transferred, or where you've got a railroad car that isn't owned by the seller at the time of the sale, whether that was transferred, too. Those are very different situations from what we are dealing with here, your Honor.

THE COURT: But you do have a statute here in Puert Rico that says, at least for tax purposes, the Commonwealth isn't the owner of the sales tax revenues until they are collected. In 2007, the sales tax revenues that are being collected in 2018 clearly hadn't been collected. So if there is a transfer, how could it be more than an expectation or a transfer of something when the thing that becomes concrete?

MR. YANEZ: Your Honor, so, too, in my rent example I, as the owner of the apartment building, won't, I suppose, in some sense, own the rent payable next month or the month after until it's handed over to me. Courts recognize that in addition to the individual instances in which payments are made, those individual instances, together, add up to a stream of revenue that is an asset in itself that can be transferred.

THE COURT: Is there a significance in the constitutional prohibition on the transfer of the right to go and collect? Couldn't the buyer with the right to the rental stream, either directly in that contract or, if things go south, go and displace the landlord as the collector of the rents and use some self-help there? It seems to me that the

Constitution says that the Commonwealth can't let somebody else do that, can't let COFINA go and do that. Is that a material difference?

MR. YANEZ: I don't believe it is, your Honor. And this goes back to an answer that I at least meant to give earlier if I didn't. That is that the antisurrender provisions of the Puerto Rico Constitution don't operate at sort of fine levels that are being conveyed here. What those provisions mean is that the power to tax cannot be infringed by other branches of the government.

In terms of the mechanics of the use, the exercise of the power to tax, including the exercise of that power through the transfer of a stream, I think that the Commonwealth would have some leeway there, but I also think that fundamentally collection doesn't matter. The reason that collection doesn't matter is that it is possible to collect something that is owned by and has been transferred to someone else. That's what happened here, Judge.

I also want to speak to the notion that this is somehow, if one looks through the substance --

THE COURT: I am going to give you a minute and 30 seconds to do that because you're in overtime now, and then I am going to have another question for you as well.

MR. YANEZ: Thank you, Judge.

I can be very quick on whether it's financing. It'

not. The reason it's not is that the words of the statute matter. Words of the statute are transfer of property of COFINA. They don't talk about it being a financing They don't talk about liens. They don't talk about anything other than ownership. And we would submit, Judge, that the terms of the statute should be respected here.

Your Honor also asked earlier and invited us to comment on whether the Court needs to resolve the question of substitution in connection with these proceedings. I can speak to that or hold off and answer your Honor's question.

THE COURT: You can speak to that very briefly.

MR. YANEZ: My answer is that the Court need not resolve the question of substitution because it doesn't detract from the fundamental command of the statute.

THE COURT: Now, the question that I want to ask yo is to respond to Mr. Despins' argument that your 2007 theory, once you take into account the mandate to pay over substituted assets, whether that's a forever thing or a particular situational thing, makes your ownership concept completely aspecific and quoting, therefore, absurd that you have a right to the revenues, you have a right to anything that might be substituted by the revenues, and you own it all 20 years before any of it ever happens.

Is there a flaw in that reasoning?

MR. YANEZ: There is, Judge. And the flaw is that we

have not asserted that COFINA owns anything that might be substituted for the pledge sales tax.

THE COURT: Thank you.

MR. YANEZ: Thank you, your Honor.

THE COURT: Mr. Kirpalani.

MR. KIRPALANI: Thank you, your Honor. I wish it said 15 minutes, but it's going down to five.

For the record, Susheel Kirpalani from Quinn Emanuel. I am going to jump a little bit, but I am going to get within my five minutes. If you have questions at the end, I would love to hear them.

THE COURT: Just remember the reporter needs to be able to write down what we say.

MR. KIRPALANI: I promise not to do Spanish on you.

The thing that's bothered me about the Commonwealth agent's argument from the very, very beginning, this whole concept of natural law, what's possible, what's not possible. The comment that COFINA can't have what doesn't yet exist, it presupposes something that also is wrong. I think your Honor hit upon it in one of your last questions to Mr. Yanez, which is, if the government -- the statute doesn't say the common law. It says the government, which includes COFINA -- doesn't own revenue until the revenue is actually delivered or collected, then why is it the right answer that upon collection or upon -- right now it's my money in my pocket. I go to this

the store, I buy the TV, right. And then the merchant collects my 7 percent sales tax or 11 and a half percent, with the surcharge, sales tax.

At that time, right before that transfer from me, the customer, it was my property, right. And so why is it correct to start with the supposition that upon the payment being made it becomes the Commonwealth's property? That's just made up. The statute tells you, when it becomes an actual piece of cash from the transaction, who owns it. It's COFINA.

I realize baseball season started last week, but there is no tie goes to the Commonwealth here. You look at the statute to determine who is the owner upon the collection and it's the Commonwealth who imposed that tax, imposed that statute, and told us who is going to be the owner, and it was COFINA. So that's my answer to the who owns it question.

THE COURT: Is that also your answer to the when whoever owns it owns it question? If so, is there any significance in the difference between my TV purchase today and 2007?

MR. KIRPALANI: No. Because what was transferred was the right to those revenues. When and if items are sold in the future, who will be the owner was determined by the legislative assembly in 2007 and it specifically said, it shall not be available resources.

We haven't talked at all about that second section.

There is no ambiguity in what the legislative assembly said in that second paragraph after Section 12(a) of the COFINA Enabling Act. The second section says, and this is how it will be deposited, those future sales, and it shall not be property of the Commonwealth and shall not be available resources. It shall not be given to the Secretary of the Treasury. All of that was done in 2007. So I don't think it changes when the actual transfer had occurred.

The GO bondholders say the -- this is another point here your Honor, shifting gears. The core tax revenues can't be transferred, but airport fees, other taxes and fees used for special purposes can be transferred. But they say it fast in the hope that nobody reads the Constitution. There is nothing in the Constitution that talks about this distinction, this dichotomy that is being drawn.

Let's take a simple example. How about PREPA? How about PRASA? These are the core essential governmental functions of any civilized society to provide clean water, to provide electric power for the people. Why are the fees and surcharges that are applied to that power generation and that water cleanliness not available resources? Why aren't the PREPA bonds counted against the debt service limit? The only reason is because, I would submit, the GO bondholders don't want to go there. But their argument proves too much.

Your Honor, I think, was correct in the questions t

Mr. Stancil that the text of the Constitution only applies to debt limit to what it applies it to. We are not here to redebate whether that's a good thing or not. It did seem a lot like this is a political question as to whether that's a good way to create a state or not a good way, and we know different states have done it differently.

The last thing I'll leave you with, because I'm about out of time, is that a lot of states don't even issue GO bonds. They don't want to give full faith and credit for exactly the reasons that we are here today, because that is when those really tough ugly choices have to be made about whether bondholders should be paid or whether hospitals should be closed when people need medical services. COFINA is not about that, your Honor. Thank you.

THE COURT: Thank you.

Mr. Mayer.

MR. DUNNE: You are correct. Mr. Mayer has three minutes left, and I believe Mr. Mayer ceded two of his three minutes to me.

I apologize in advance to the court reporter. I will try not to do speed argument.

Couple of quick points and I am going to jump around, your Honor. The first one is indulge me in a quick thought. Let's assume we are back in '06 for a moment. Let's assume Mr. Rosenberg and Mr. Stancil are representing a bond group

that is coming up for refinancing at that time, and the Commonwealth is encountering some market difficulties with respect to the cost of that capital. And the Commonwealth decides, I can create a new tax. Call it the SUT.

The GOs would have two choices. They could wait for that SUT to be collected over time. And as that SUT gets brought into the Commonwealth, it becomes available resources for the GOs, but they would realize that may take years or decades to accumulate to sufficient size, or they could avail themselves of a standard securitization structure to monetize that stream in exchange for permanent and immediate sale of present and future SUT collections. That structure itself could then issue bonds. The proceeds of those bonds would go and pay off the GOs. They would become available resources of the Commonwealth and pay them off. They would look at the Puerto Rico Constitution. They wouldn't see any antidedication of revenue provision, and they would see that this isn't used to calculate the debt limit. I suspect the GOs would pick door No. 2. It's an easier way to be repaid. That's a supposition and beside the point.

What matters is they can't have both doors. What they can't have is both the SUT over time and the proceeds of the bonds. What the new bond proceeds did was, they ratified the SUT. It became available resources in another garb. It wasn't the SUT stream of payments over time. It was immediate. But

you can't now argue that the SUT is available resources as well for the all reasons we said.

Two other quick points, your Honor. One is, I urge your Honor to read *Hawkins*, the Indiana Supreme Court. I mentioned it in connection with Mr. Despins' arguments, but it also dealt with Mr. Stancil's *Cerajewski* case because it essentially overruled both of them, and they cite a Law Review article in it that will bring you to the kind of bedrock of modern municipal bond financing, and you don't recast legislative enactments.

Lastly, your Honor, on 14(c), I know that the proviso simply said substitutive collateral. It says substitutive tax income or collateral. It neatly tracks all three categories that precede it. Mr. Despins would like you to eliminate, when they are a nullity, the substitutive tax and substitutive income portions of that, and your Honor is counseled by numerous interpretive canons not to do that. I also agree with Mr. Yanez that you don't have to reach that issue.

Thank you.

THE COURT: Put on your wings, Mr. Mayer.

MR. MAYER: First, the language of the statute says future funds that must be deposited in the account that will be positive. It says this transfer is made in exchange. It was the present tense. Second, I agree with the statement that you don't need to resolve the issue with what happens if they try

to remove the taxes.

I would point out there are at least three highest court in state cases, starting with *Pierce County v. State of Washington* that holds that you can't just repeal a tax once pledged to bondholders, even where your Constitution retains the power to repeal the tax. And that's 148 P.3d 1002 (2006). If this becomes an issue of importance to the Court, you can ask the parties to brief it. Thank you.

THE COURT: Now we return to the Commonwealth.

MR. STANCIL: Your Honor, I try to get six minutes. It's very dramatic to watch that ticking away.

Let me come back.

THE COURT: Try to keep it exciting.

MR. STANCIL: No one would accuse me for lacking excitement of the subject matter.

Let me start with the text. We alone, we alone, ou side alone offers a coherent meaning to the term available resources in section 2, section 7, and section 8 of the Constitution. They don't like it. But they have nothing to say that makes that provision make sense in context

Mr. Yanez ends up doing what I think is in fact exactly backwards and says, the general taxing power controls over the specific provisions that control fiscal responsibility, 180 degrees opposite, your Honor. The specific governs the general.

If he were correct, the broad taxing power would be licensed to ignore First Amendment restrictions, the restriction on public school, private school support that I was referencing earlier. That's not how it works. It's exactly upside down.

The fact that the drafters may not have predicted this exact method of evasion is not an answer. I encourage the Court to please read the *Maestros* case that we cite. It goes through exactly the mode of interpretation that we are offering for the text here, which is, it speaks only to support for private schools, should that also reach support for private school students, and the Court had no trouble looking at Trias Monge, looking for the purpose of this provision in concluding yes. This is exactly what the Puerto Rico Supreme Court has done and will do.

Please also read *Cerajewski*, the Indiana case. Mr. Yanez said, well, the debt restriction there this is a little different. It is a little different, but the mode of interpretation is spot on. There was no express prohibition in *Cerajewski* of having these overlapping taxation districts. I won't quote because I get in trouble when I start quoting and reading too fast. If the Court will look at page 652 of that decision, the Court walks through and says this would be a simple end run around the clear principle that's articulated in their debt limit provision.

Mr. Yanez says, well, if it's a loophole, the answer to that, I believe, he said is well the legislature has discretion. That doesn't work for constitutions. A constitutional loophole by definition cannot be solved with legislative discretion. A constitution binds the legislature, even and especially when it doesn't want to be bound. That is the defined feature of a constitutional restraint.

THE COURT: I think he is saying it's not a loophole. It's a grant of discretion.

MR. STANCIL: I think beauty is in the eye of the beholder on that, your Honor. I guess I would say it's not a loophole. How are we where we are?

With respect to the drafting history, 100 percent, 100 percent of the drafting history supports our interpretation. Mr. Yanez says, well, it applies only to the governor. That is flat wrong. Let me explain what he's trying to do. Trias Monge says that it places these resources, all resources, in absolute first term beyond the power of the governor.

The reason he said governor is because under the Jones Act, which preceded the Constitution, the governor had discretion to reorder the priority. They took that away in the Constitution. They didn't grant the legislature some power or suggest that there is some legislative exception to the plain text. He says, and I think I would look also to the text of article 6. Section 8 says nothing about the legislature shall

not. It says the debt gets paid first. Moreover, if you look at the subject heading to article 6 it says, general provisions. It doesn't say executive legislature, like the earlier articles do.

Last, and not least, there have been a couple of attempts at tactical effect arguments. That takes a few different forms. The first is the double counting argument. Well, he made available resources. The proceeds can't be available resources and you have the available resources in the SUT going forward. That's not right. Any impermissible financing, by definition, yields immediate proceeds, but that doesn't make it permissible.

So the fact that they generated available resources in 2006 and in subsequent issuances says nothing about whether they had the authority to try to claim the resources that became unavailable.

Moreover, we heard Mr. Kirpalani, in particular, says, COFINA is not about taking essential services away. COFINA is not about that. With respect, your Honor, he is dead wrong. The Constitution gives us, and I understand that your Honor had pushed on this, but the Constitution I think clearly gives the GOs first priority over all funds, and the statute reconfirms that constitutional demand.

Look at what COFINA does. If the Court is concerned or if Mr. Kirpalani is concerned about bondholders coming ahead

of the essential services, ask the COFINAs where is their constitutional authority to take 40 years of tax revenue ahead of any service whatsoever. There is absolutely no basis for this. If anyone is concerned about grabbing a head of essential services, it should be the COFINA structure, which takes all that money off the table before it even gets in the door, or at least tries to.

This has nothing to with PREPA or PRASA or energy or water. The drafting history, again, is crystal clear that public corporations that generate their own revenue don't count. They are outside of the constitutional framework for the reason that revenue bonds everywhere, real revenue bonds, are outside the Constitution.

COFINA is not a real revenue bond. It's an off-book financing scheme designed to evade all of these limits. With respect, your Honor, the only way forward for Puerto Rico is to go back to the constitutional intent.

THE COURT: Thank you.

Mr. Despins. As you're walking up there, Mr. Despins, I will need to hear from you because I haven't heard from Mr. Stancil or the Retirees how you walk through the English Spanish thing as well.

On the balanced budget amendment, because I understand it's your position that it is the English language version that controls, and I haven't had anyone come up to me and point me

to definitive documentation other than speculation that Mr. Truman read all of his legislation himself and had no expert assistance ever.

MR. DEPSINS: Your Honor, I am not the right person to answer this, meaning my colleague here can answer it. I'll try to cover the rebuttal points very quickly, and he will come up to address that.

Let me go through this very quickly, because there is not a lot of time, the question about a loan, how does it work and all that. Page 18, and footnote 6 that goes on page 18, document No. 322 in the adversary proceeding.

The next point I want to address is this issue that if you were to rule for the Commonwealth on this, and Mr. Mayer said that's the end of access to capital market, let me just remind everyone and the Court that Argentina, not in this courtroom, in this courthouse, sort of, not literally, but tortured the bondholders for about 10 years here going back and forth three times to the Second Circuit.

And at the end of the day they did a century bond offer, century meaning a 100-year term. It was oversubscribed. This idea that somehow if the Court were to rule that a statute works in one way, not the way they thought -- although, frankly, the way everyone at the time thought it worked -- that somehow it will cut off access to capital markets is just wrong.

Your Honor, the points raised by Mr. Kirpalani referring to Section 201407 and also the section regarding confirmation in the PROMESA statute raise the question of advisory opinions. And built into all these sections, the point is there has to be a valid priority. There is not a section that says, COFINA gets a pass. It's whatever the Court determines COFINA to be.

The other point is, your Honor, on accounting I wan to refer the Court to our briefs on that. But the reason why accounting is important, your Honor, is not because you are bound by that but because they found that this was a secure transaction, not because of some crazy accounting rule, but because they found that the Commonwealth kept control over the process and that defeated any other type of treatment. It defeated a true sale treatment and that's not binding on the Court, but it's illustrative of what's going on.

Your Honor, on the argument regarding 14(c), these are all fascinating arguments, but at the end of the day you have to look at the various opinions. In their own bond statement that belie this whole argument that 14(c), the proviso, the first part of the proviso is subject to substitutiv collateral.

Then the other question you asked Mr. Yanez is, wha about the point that if you are right, the transfer of substitutive collateral occurred in 2007. The response was, we

have never asserted that.

Your Honor, it's nice for them to say that. That's not the way the statute works. We have a principal approach on this. They are saying that, no, because they don't care. They know there won't be a substitutive lateral. That's very cute. But the statute itself calls for a substitutive collateral to be deposited in that account. If we are going to follow the statute, they can't just walk away from that and say, we are not asserting that. The statute actually reads that way.

At this point I would ask Mr. Bliss to come up to address the Spanish issue.

THE COURT: Thank you.

MR. BLISS: Your Honor, James Bliss of Paul Hasting on behalf of the Commonwealth agent. I understand I have a minute and that minute is elapsing as I speak.

The argument is that under the Federal Relations Act of 1950, Congress authorized the people of Puerto Rico to adopt the Constitution. That act provided that, quote, upon approval by the Congress, the Constitution shall become effective.

THE COURT: I think it says upon approval by the Congress adoption thereafter by the constitutional convention and proclamation by the governor becomes effective. It goes back to the island presumably in Spanish if you are going to go by what language people are likely to read. How does that make English definitive?

MR. BLISS: Your Honor, you're referring to law 447 which amended the Federal Relations Act to approve the Puerto Rico Constitution. That law provided that, quote, the Constitution of the Commonwealth of Puerto Rico, hereby approved, shall become effective when the constitutional convention of Puerto Rico shall have declared in a formal resolution its acceptance in the name of the people of Puerto Rico of the conditions of approval herein contained and when the governor of Puerto Rico, being duly notified by the proper officials of the constitutional convention of Puerto Rico, if such resolution of acceptance has been formally accepted, shall issue a proclamation to that effect.

By the plain terms of law 447, it was the version hereby approved.

THE COURT: And do you have a document that you can point me to that shows that the version hereby approved was solely an English version, not an exhibit with an English and a Spanish version, not an English version that says, if this is an English translation of the Spanish version? Is there something besides the brackets that you all inserted in the quote from 447 that makes it definitive that the English version was the only thing that was ever approved?

MR. BLISS: What we have is President Truman and members of Congress did not speak or read Spanish.

THE COURT: They can't hire people who speak Spanis

and can talk to them about what the Constitution says?

MR. BLISS: We also have the point that the Congres conditioned its approval on certain amendments which were presented in English.

THE COURT: This provision wasn't amended, correct? It wasn't sent back in English. It wasn't specifically redrafted and sent back in English?

MR. BLISS: That's correct, your Honor. Thank you, your Honor.

THE COURT: I am as ever grateful to you all for th care that you put into your briefs, the arguments today, and for engaging me on these questions, which are obviously very serious, very difficult, and quite consequential for Puerto Rico. I will equally seriously carry this under advisement.

I am looking forward to the arguments on the 25th about who should be deciding the constitutional questions, and we will all be in touch and seeing lots of each other, I'm sure.

MR. DEPSINS: Your Honor, I was asked to raise this point by the litigators of my shop. This is not a criticism on anyone, but there is a schedule set to resolve this issue, including the potential trial. I'm not saying we shouldn't, but I'm just saying that there is that.

Both Paul Hastings and Willkie Farr are preparing, because they have to prepare because the schedule is so tight,

for the potential trial. That's costly. It involves expert witnesses, which you may never hear from.

The point is, would it make sense to suspend the scheduling for now so that we don't have to incur those costs going forward? Because it will save money for everyone. I don't think the COFINA agent would mind that.

THE COURT: That is an application that you all could make that hasn't been made to me yet. It does seem to me that in all of the briefing and argumentation, no one has certainly taken the global position that there are any material issues of fact that preclude resolution of this question as a matter of law. There are a few little pockets of things, depending on where one goes in the Venn diagram. It seems to me that among the people who have briefed these issues who are parties, there is no one saying that there is anything that has to be resolved in a trial.

Is there anyone who is a party to this case who would oppose this oral application for a stay of the trial preparation requirements pending determination of the motions for summary judgment? Raise your hand if you oppose it.

The trial preparation requirements are stayed pending further order of the Court.

MR. DEPSINS: Thank you, your Honor.

THE COURT: Thank you. Good afternoon, everyone.

(Adjourned)

UNITED STATES DISTRICT COURT)
) ss.
OF PUERTO RICO)

REPORTERS' CERTIFICATE

We, Steven Greenblum and Carol Ganley, do hereby certify that the above and foregoing, consisting of the preceding 130 pages, constitutes a true and accurate transcript of our stenographic notes and is a full, true and complete transcript of the proceedings, to the best of our ability.

Dated this 10th day of April, 2018.

S/Steven Greenblum_____

S/Carol Ganley_____

Steven Greenblum, RMR, CSR, RPR, CRR

Carol Ganley, RMR, CSR, RPR, CRR

Official Court Reporters

500 Pearl Street

New York, NY 10007

212-805-0320